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BusinessWeek



LOOK WHO'S STALKING WAL-MART

Target is going downmarket to get through the consumer recession. But can it keep its cachet?

BY MICHELLE CONLIN

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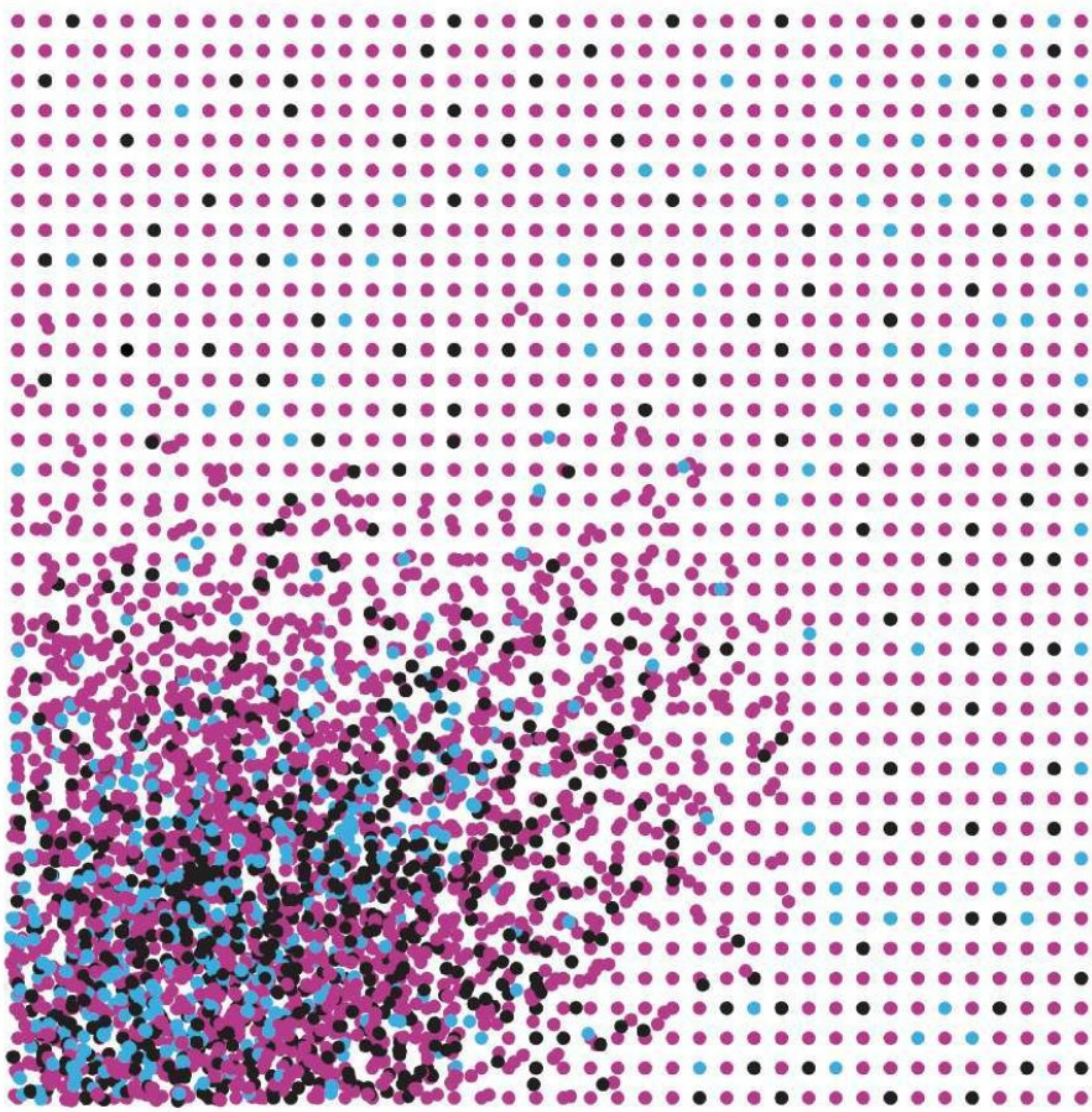
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Charles Onyango Apiyo blames Dominion Farms for the deaths of many of his cattle

(OUTSIDE COVER) SHAKENA THORNTON; (THIS PAGE) TIM FRECCIA

IN DEPTH

RETAIL SPECIAL REPORT

LOOK WHO'S STALKING WAL-MART

030 | Target is battling the recession by stressing low prices. But can it move downmarket without losing its long-cultivated cachet?
ALSO: While Old Navy is enjoying a sales uptick, it may still be at sea. | BW |

LAND RUSH IN AFRICA

038 | Agribusiness and global investors are scooping up vast tracts of farmland across the continent. Some, like Dominion Farms' Calvin Burgess, say they're boosting local economies. But in Kenya, foreign investors are stirring resentments. | BW |

OBAMA'S BIG GOV SWAT TEAM

044 | The White House has a small cadre of technocrats hard at work on a "new performance compact" where the government gets the maximum bang for the big bucks it spends. Policy experts wonder if they can really remake the ways of Washington. | BW |

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BEHIND THE STOCK RALLY

Sure, the Dow and S&P 500 are flying. But some see a "melt up," where large institutional players generate market momentum that has little to do with economic reality. |BW| PAGE 024



Roche senior executive Pascal Soirot and Genentech CEO-to-be Ian Clark

PHOTOGRAPH BY ANDY FREEBERG

CAN ROCHE LEAVE GENENTECH ALONE?

The Swiss pharmaceutical giant has generally kept its hands off its San Francisco-based drug-development partner, yielding many blockbusters. Now that it owns it outright, the challenge is not to mess with a formula that works. |BW| PAGE 048

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004 THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD

FINANCE

BULLS KEEP SNORTING

Don't look now, but the current runup in U.S. stocks ranks as the greatest intrayear rally in nearly 75 years. On Nov. 24 the S&P 500 stood near a 13½-month high, up a thumping 63% since its nadir on Mar. 9. Gazing out over the economic landscape, investors appear to be ignoring signs of weakness—the dismal jobless rate, shaky consumer confidence, desperately strapped states—and fixating on signs of strength. Third-quarter real GDP growth, revised down to a 2.8% annual rate from 3.5%, still squared with expectations. Profit growth at U.S. financial companies topped 36% for the quarter, pushing overall corporate earnings to a 10.6% gain—the best since 2004. The **S&P/Case-Shiller U.S. National Home Price Index** notched its second consecutive quarterly improvement. Housing prices could continue to stabilize as inventories shrink: In October, existing home sales were up 10% to an annual rate of 6.1 million, the fastest pace since February 2007. With the dollar languishing, gold set a new record of $1,174 an ounce on Nov. 24—but the weak dollar seems to be pushing investors to seek richer returns in stocks. The Fed, in its minutes of the Nov. 3-4 meeting, expressed mild anxiety that infinitesimal interest rates might fuel "excessive risk-taking" in the financial markets. But for now, the Wall Street party rocks on.

| BW | PAGE 020 "The Slow Road to Jobs" PAGE 024 "Behind the Great Stock Rally of 2009"



A Big Board trader on Nov. 23: The S&P 500 is up 63% since its low in March

RICHARD DREW/AP PHOTO

THE BIGGEST LOSERS

U.S. states that have logged the biggest declines in corporate income tax revenue*

-111.3%	Ohio
-72.5%	Utah
-68.4%	Alaska
-67.3%	Iowa
-61.8%	Delaware
-19.4%	U.S.

Data: Rockefeller Institute.

A NEW RATINGS LAWSUIT

The big credit-rating agencies are snarled in a thicket of lawsuits from private investors enraged that the companies gave favorable ratings to mortgage-backed bonds that subsequently tanked. Now the legal pressure has been turned up: On Nov. 20, **Ohio Attorney General Richard Cordray** filed suit, saying the agencies had "sold their...integrity to the highest bidder." Cordray claims the "improper" ratings from **Fitch, Moody's,** and **Standard & Poor's** (owned, like *BusinessWeek* until Dec. 1, by **The McGraw-Hill Companies**) wrecked the housing and credit markets and caused Ohio pension funds to lose more than $457 million on securities they bought. Moody's and S&P said the suit has no merit. Fitch declined to comment.

2.8%

U.S. GDP growth in the third quarter, revised downward from 3.5%

Data: Commerce Dept.

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ECONOMICS & POLICY

REFORMERS WIN ONE

So far the Democrats are keeping their troops in formation—but how long will that last? On Nov. 21 the **Senate** voted to move the **Finance Committee** health-care reform bill to the floor for debate by a vote of 60 to 39. A lot of arm-twisting sufficed to keep all the Democrats, even those talking against the bill, on the "yes" side of the aisle, while not a single Republican broke ranks to vote in favor. Floor debate will start after Thanksgiving and likely go on for weeks, with one erstwhile supporter, **Senator Joe Lieberman** (I-Conn.), warning that he plans to be "stubborn" in seeking changes. Look for intense disputes over a government-run insurance plan, taxes to pay for reform, and abortion funding.

SMOKE AND LAWSUITS

Back in 2006, the **Florida Supreme Court** ruled that the state's smokers couldn't sue tobacco companies as a class. However, it left 4,000 plaintiffs eligible to try their claims individually—and one of them just won a cool $300 million. On Nov. 19 a Florida jury ruled against **Philip Morris USA** and awarded $56 million in compensatory damages and $244 million in punitive damages for the illness of longtime smoker **Lucinda Naugle.** The company will appeal the verdict, which one of its lawyers termed in a statement "grossly excessive" and "the result of numerous erroneous rulings."

SHAKEUP IN DUBAI

One doesn't usually think of Persian Gulf states as struggling debtors, but Dubai, in fact, is laboring under a $90 billion mountain of borrowed money. So on Nov. 20, **Sheikh Mohammed bin Rashid Al Maktoum** demoted some of the energetic young officials who led the emirate's boom. He replaced **Omar Bin Sulaiman,** the well-liked governor of the **Dubai International Finance Center,** Dubai's would-be Wall Street of the Mideast, with a veteran businessman and official, **Ahmed Al Tayer.** Three other central

Al Maktoum demoted some of the architects of Dubai's boom



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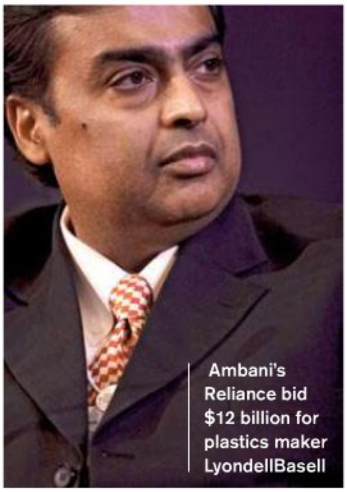


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Ambani's Reliance bid $12 billion for plastics maker LyondellBasell

figures—**Mohammed Alabbar,** chairman of developer **Emaar Properties; Dubai World** chief **Sultan Bin Sulayem;** and **Dubai Holding** boss **Mohammed Al Gergawi**—all recently quit the board of **Investment Corp. of Dubai,** which oversees the government's stakes in key operations such as **Emirates Airlines.** The goal appears to be to placate financial backer **Abu Dhabi** as well as Dubai's big merchant families.

STRATEGY

CADBURY FOOD FIGHT

Like kids grabbing for a candy bar, the world's largest makers of edible goodies may soon be battling for British chocolatier Cadbury. On Nov. 18, **Hershey's** and Italy's **Ferrero** confirmed that they were mulling bids, which could put pressure on **Kraft** in the wake of its $16.4 billion hostile offer for Cadbury a week earlier. Then rumors proliferated on Nov. 22 that Swiss behemoth **Nestlé** could belly up to the table as well, teaming with Hershey in a joint effort to soothe European antitrust concerns.

"Why the Cadbury Deal Matters" businessweek.com/magazine

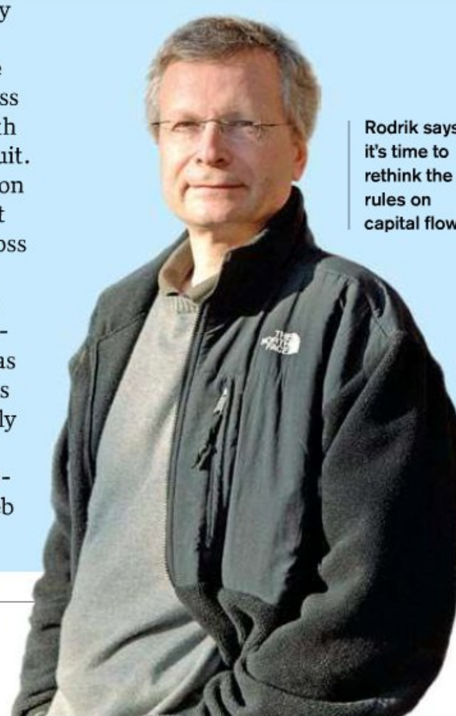
RELIANCE'S BIG BID

Dow Chemical. Germany's **BASF.** And now, **Reliance Industries** may add its name to the list of the world's top petrochemical giants. On Nov. 21 it offered around $12 billion for bankrupt **LyondellBasell Industries,** a once-American, now Dutch plastics manufacturer. Cash-rich Reliance could pay off the hefty price tag in less than two years, say analysts. While Indian companies have had a checkered history buying troubled overseas assets—see **Tata Motors** and **Jaguar Land Rover**—Reliance chief **Mukesh Ambani,** India's richest man, is a disciplined and ruthless negotiator. Bank-

IDEAS SHOULD DEVELOPING NATIONS CLAMP DOWN ON HOT MONEY?

They're baaaack. Brazil's recent decision to introduce a 2% tax on short-term capital inflows has rekindled a debate over the merits of capital controls, which some among developing nations used in the 1990s to guard against asset bubbles and currency appreciation. Indonesia and Taiwan have made moves in the same direction as Brazil, though with less fanfare. Officials in India and South Korea are considering following suit.

Hardcore free marketers frown on controls on principle, arguing that capital should be free to move across borders. Even the **International Monetary Fund,** which under the leadership of **Dominique Strauss-Khan** has sought to portray itself as less doctrinaire on such issues, has inveighed against controls—mostly on the grounds that they usually don't work. Yet in a November column on the **Project Syndicate** Web site, **Harvard University's Dani Rodrik** argues the time has come to launch a new dialogue, free of "ingrained financial fetishism," on how developing countries can best protect themselves against speculative capital.


Rodrik says it's time to rethink the rules on capital flows

And **Arvind Subramanian,** of the **Peterson Institute for International Economics,** floated in a Nov. 25 column in India's *Business Standard* the idea that developing countries should band together, under the umbrella of the **Group of 20,** and institute capital controls in concert. Such an approach, says Subramanian, would take care of the stigma problem and make controls more effective.

Dani Rodrik: "The IMF Needs Fresh Thinking on Capital Controls"
Arvind Subramanian: "Coordinate Capital Controls"

(TOP) SANJIT DAS/BLOOMBERG NEWS; (BOTTOM) JODI HILTON/THE NEW YORK TIMES/REDUX

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Microsoft's Steve Ballmer may team up with Rupert Murdoch

CHRIS TZOU/BLOOMBERG

ers expect his all-cash offer will trump cash-and-stock bids from unnamed rivals.

BOFFO AT EVERY BITE

What is it that teen girls see in vampires? Seduced, perhaps, by the fantasy of the ultimate bad-boy romance, teens swarmed movie theaters on Nov. 20 to see *The Twilight Saga: New Moon*. The $72 million gross broke *The Dark Knight*'s one-day record, and the film, produced for $50 million by independent studio **Summit Entertainment,** garnered an eye-popping $142 million by the end of the weekend. That kind of appeal will almost certainly put *New Moon*, already ranked 15th for the year, among the top 10.

THE LAST SAAB STORY?

As with the **Opel** saga, this one is becoming a cliffhanger, but it could have an unhappy ending. On Nov. 24, Swedish sports car maker **Koenigsegg Group** pulled its bid to buy Saab from **General Motors.** GM would like to ditch the brand at the same time it is disposing of **Saturn** and **Pontiac.** Koenigsegg didn't explain its U-turn, but Saab has long lost money, and its sales are projected to skid from 91,000 last year to 41,000 in 2009.

TECHNOLOGY

TWO AGAINST GOOGLE?

Rupert Murdoch wants to loosen Google's iron grip on the news—and **Microsoft** wants to help. Murdoch's **News Corp.** has held early-stage talks with the Redmond (Wash.) software giant to forge a deal that would strip *Wall Street Journal* content from Google's search engine, says a person familiar with the talks. Microsoft would pay an undisclosed fee in exchange for the anticipated bump in visitors to its **Bing** search engine, according to the *Financial Times*, which first reported the discussions on Nov. 22. But the arrangement could leave Microsoft and News Corp. vulnerable to allegations of anticompetitive behavior while cutting Murdoch's properties off from one of their main sources of readers: 26% of the *Journal*'s online traffic arrives via the Web giant.

| BW | PAGE 026 "Murdoch vs. Google"

HP'S STRONG QUARTER

Hardware? Fuhgettaboutit. The black ink for **Hewlett-Packard** these days continues to flow from services. Despite major revenue declines in four of its core businesses, including PCs and printers, profits jumped 14%, to $2.4 billion, in the fiscal fourth quarter, ended Oct. 31. HP slashed computer prices to maintain its standing as the world's No. 1 PC maker, but the company has gotten a big boost from its $13.9 billion purchase last year of Electronic Data Systems, now **HP Enterprise Services.** And **CEO Mark Hurd's** cost-cutting is expected to brighten HP's bottom line when the recovery strengthens.

THE *BUSINESSWEEK*/ YOUGOV OPTIMISM METER

A TAD GLOOMIER



The Optimism Meter, a proprietary measure of sentiment and expectations, economic statistics, and market forecasts, dropped by a point the week of Nov. 24, to 45, as consumers grew gloomier about jobs and less confident that stocks will keep rising. Developed to track shifts in outlook among individuals, professional investors, and economists, the meter gauges optimism about jobs, markets, and growth.

*Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest

Data: YouGov, Bloomberg, *BusinessWeek*

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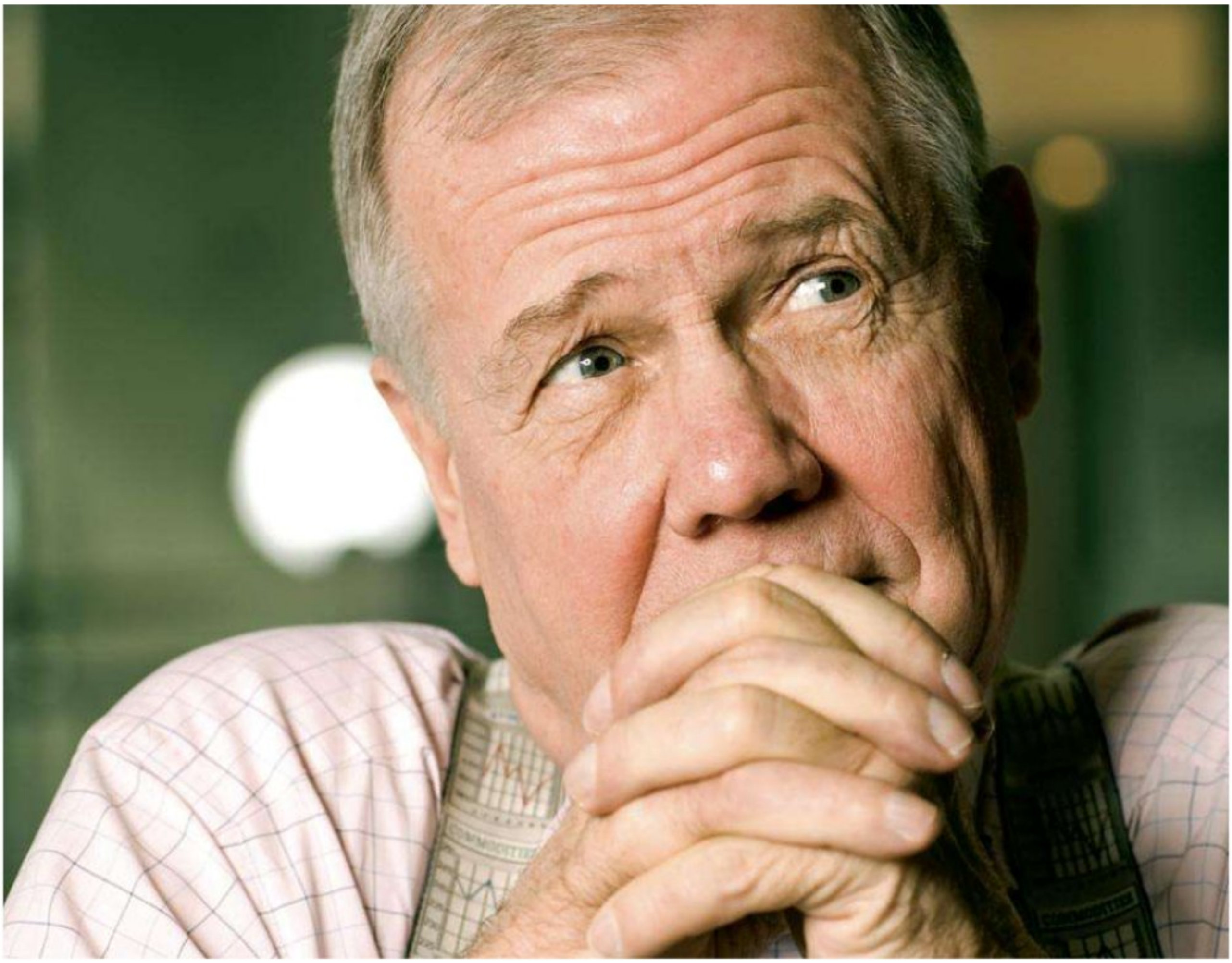
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FACETIME | MARIA BARTIROMO





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JIM ROGERS ON WHY GOLD IS GLITTERING SO BRIGHTLY

I was on assignment in Singapore on Nov. 24 when gold hit an all-time high of $1,174 an ounce. That was fortuitous because Singapore is the home base of commodities guru Jim Rogers, creator of the Rogers International Commodities Index. Meantime, back in the U.S., reports were surfacing about growing discontent in the halls of Congress over the performance of Treasury Secretary Tim Geithner and the possibility he might be replaced by JPMorgan Chase CEO Jamie Dimon. When I rang up Rogers, he was his usual low-key self, with quiet opinions about the future of gold prices, commodities to watch, and why Obama should dump Geithner.

MARIA BARTIROMO
Gold, as you know, hit an all-time high today, with the Russian central bank buying bullion. How high can gold go?

JIM ROGERS
Well, I own gold and I have for a while. How high can it go? I fully expect it to be over a couple thousand dollars an ounce sometime in the next decade—I didn't say the next month, I didn't say the next year, I said the next decade—

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because paper money around the world is very suspect. But right now everybody's bullish on it, so I don't like to buy things when that's happening. But I'm not selling under any circumstances.

What's behind the runup? Has buying by the central banks changed the equation here? Or is this still a demand story?
Certainly a demand story because, as I said, everybody's printing so much money and people around the world are worried about that. But you also have central banks, which five years ago were selling gold, now buying. So that's a huge shift in the marketplace. Central banks are like lots of other people—they just follow the crowd. There are probably better commodities to buy than gold, but you can't tell that to central banks because they've got gold on the brain.

How much of the runup is being driven by U.S. deficits and the weakening dollar?
A huge amount is about not just U.S. deficits, but all deficits. Deficits are going berserk nearly everywhere. Throughout history, printing money has led to weaker currencies and higher prices for real assets. And there are many, many pessimists about the dollar, including me. So many pessimists that I suspect there's a rally coming. I have no idea why there should be, but things do usually rally when you have this many bears at the same time. I've actually accumulated a few more dollars. I mean, it's not a significant position, but I do own more dollars than I did a month ago. And we'll probably also have a gold correction because there's so many bulls on gold.

There are many, many pessimists about the dollar.... So many pessimists that I suspect there's a rally coming

So you're looking at other commodities you think are better opportunities?



Geithner will lose his job, says Rogers, to take the heat off Obama

If you want to buy precious metal, I'd rather buy silver or palladium. Both are very depressed. I continue to be more optimistic about agriculture than some other commodities.

As *BusinessWeek* reports this week, global investors are snapping up thousands of acres of farmland in Africa (page 38). Money from everywhere—from Saudi Arabia to Wall Street-backed funds—is pouring in. Why the sudden focus on Africa?
The gigantic acreage in Africa has been underfarmed because there is not much infrastructure, not much machinery, not much expertise, not much fertilizer. I think the world is going to have huge food problems in the next few years. Other people seem to see that, too, so they're buying up farmland. You can either buy it or lease it. It's very, very cheap, it's incredibly fertile, and it hasn't been overexploited. And if you take in some expertise and some machinery and some fertilizer, you should make a lot of money. The labor's cheap, everything's cheap.

So you think Africa is a good investment opportunity?
I think it's a fantastic investor opportunity. Now there are over 50 countries in Africa, so we can't make too gross a generalization. But I mean, in the Congo, you don't even have to plant anything. You just sit by the road long enough, something will grow. Yes, I am very, very optimistic.

What's your outlook for commodities in 2010?
I'm not smart enough to know. But I will say that if the world economy gets better, then commodities will be one of the best places to be because of the shortages that are developing. If the world economy does not get better, commodities will still be the place to be because governments are printing all this money.

Tim Geithner has been under attack lately. How's he doing?
Listen, I have been a critic for years. Geithner should never have been appointed to anything. He's been wrong about just about everything for 15 years.

Do you think he'll lose his job?
Of course he's going to lose his job, because as Mr. Obama realizes that Geithner doesn't know what he's doing, he's going to look for somebody else because he doesn't want to take the heat himself. So he's going to look to blame somebody, and the obvious person is Geithner. |BW|

* This column marks the end of a four-year run interviewing heads of state, captains of industry, and lords of finance for *BusinessWeek*. In 2008, for example, there were 45 FaceTimes, ranging from Barack Obama to Sarah Palin; Carlos Ghosn of Renault-Nissan to former Time Warner chief Jerry Levin; Ken Lewis of BofA to then Treasury Secretary Hank Paulson. I have enjoyed immensely the chance to share the views of world leaders with you, and I wish the magazine well under its new owner, Bloomberg L.P.

Maria Bartiromo is the anchor of CNBC's Closing Bell and writes the blog, Maria Bartiromo's Investor Agenda, at investoragenda.cnbc.com

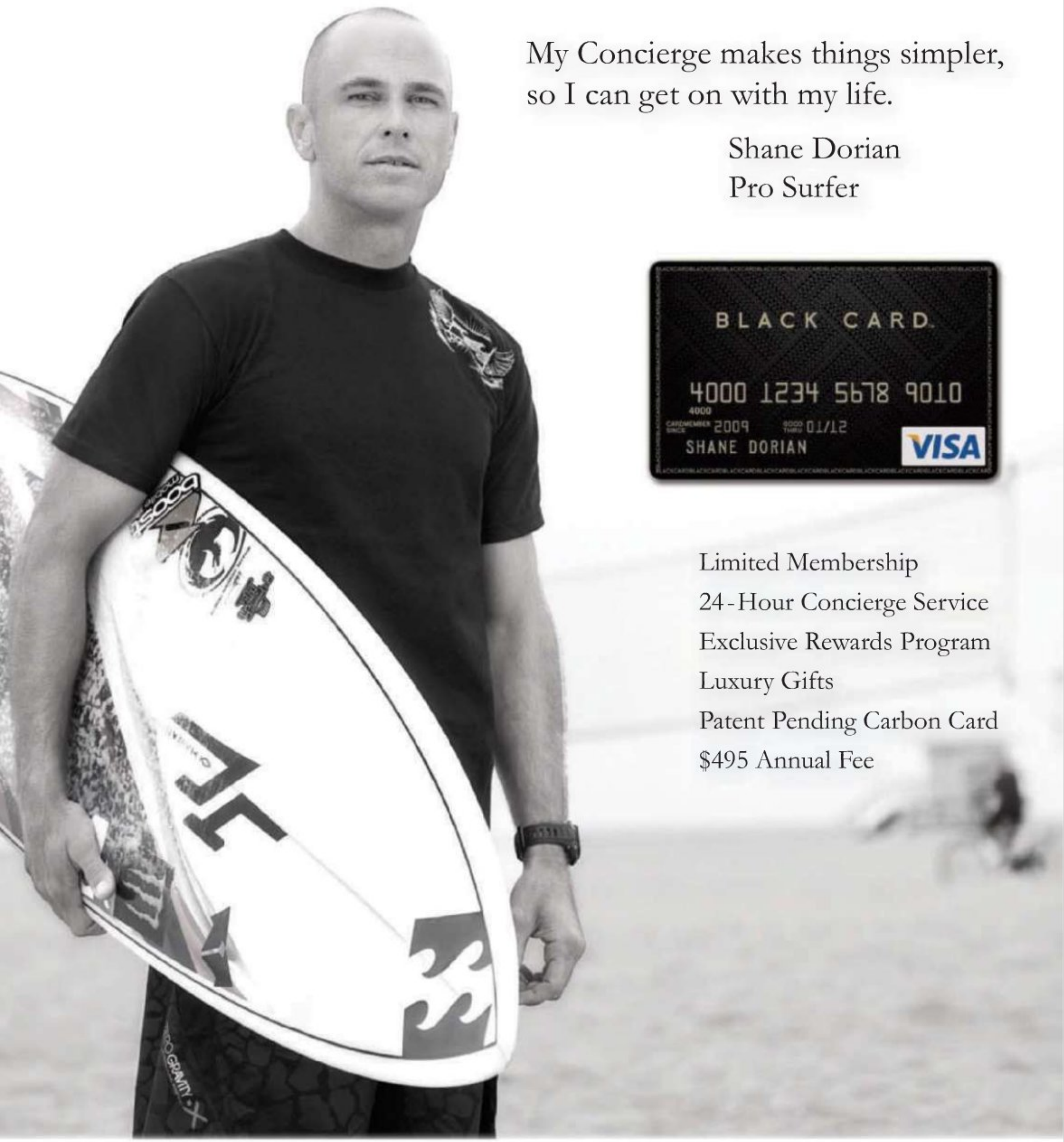
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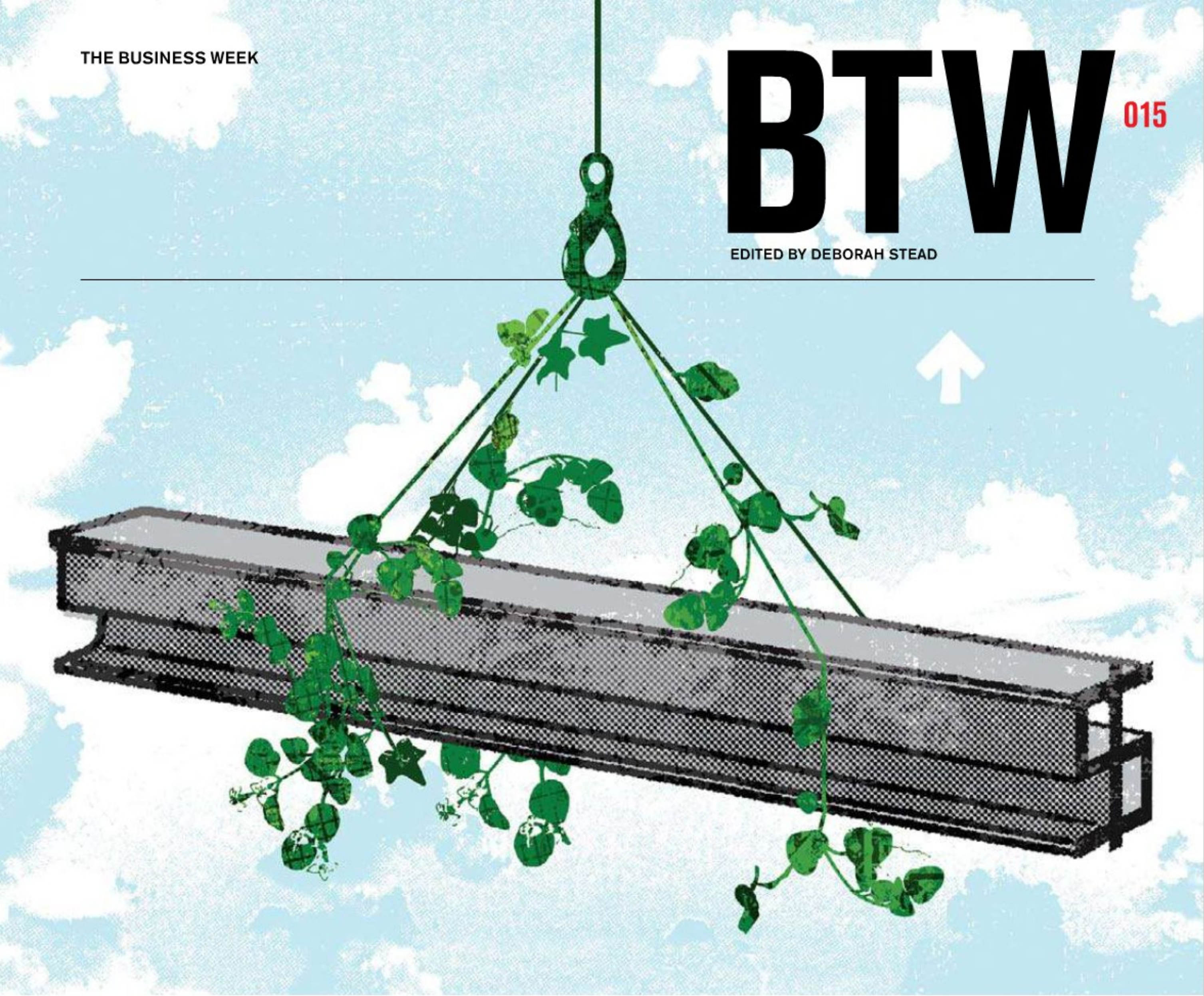


ILLUSTRATION BY GARY NEIL

THE DIVIDENDS FROM GREEN OFFICES

Green office buildings are constructed to save energy. But do better ventilation, eco-friendly carpeting, and increased natural light bring other bottom-line payoffs? Yes, according to a study by the University of San Diego and commercial real estate broker CB Richard Ellis Group. The researchers surveyed 2,000 tenants in 154 buildings under CBRE's management across the U.S., all with EPA-awarded Energy Star labels or LEED certification.

The survey found that employees took an average 2.9 fewer sick days each year in their environmentally sound offices than in their previous, nongreen workplaces—a cost savings to their employers of roughly $1,200 per worker, based on average salaries. Some 55% of tenants also reported a rise in employee productivity in their green digs—adding up to a 5% average increase worth $5,000 per worker annually. Professor Norm Miller at the University of San Diego's Burnham-Moores Center for Real Estate says the research didn't pinpoint exactly which green features made employees healthier and more productive. But "generally it's lighting and air quality," he notes.

Most tenants also expressed a belief that their healthier environments helped them retain their staffs (61%) and burnish their image with clients (74%). Energy savings? Sending tenants individual utility bills caused them to consume 21% less electricity on average.

With all this, the green buildings were able to command higher rents—$30 per square foot vs. the national average of $27. And vacancy rates were lower—about 16.6%, vs. 17.2%. David Pogue, CBRE's national director of sustainability, says that difference is "modest" partly because many of the buildings surveyed house financial-services firms that have cut their staffs. *—Christopher Palmeri*

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Botox injections could be subject to a proposed tax

HEY, GOOD-LOOKIN'— THIS MAY HURT A BIT

It has been dubbed the "Botax." The Senate health-care reform bill that will be debated after Thanksgiving includes a proposed 5% tax on elective cosmetic procedures such as breast implants, face-lifts, and Botox injections. The Congressional Budget Office estimates the tax will raise $5 billion over 10 years, but the nation's purveyors of cosmetic procedures say they and their patients are being singled out unfairly. Caroline Van Hove, a spokeswoman for Allergan, the Irvine (Calif.) company that makes Botox, argues that taxing cosmetic procedures punishes "people who have merely decided to enhance their appearance." The tax discriminates against females, she says, since 86% of people who have cosmetic procedures are working women. And unlike sin taxes on cigarettes and other unhealthy products, she adds, the tax doesn't discourage behavior that adds to the nation's medical bill. The American Academy of Cosmetic Surgery, representing 1,800 doctors, is also speaking out against the tax. Botox sales are already off 2% this year. And most cosmetic surgeons have seen a 25% drop-off in business since the start of the recession, says Steven Hopping, a cosmetic surgeon in Washington, D.C., and a past academy president. "Asking doctors to be tax collectors is unprecedented," he says. "It's a further burden on our industry." *–Arlene Weintraub*

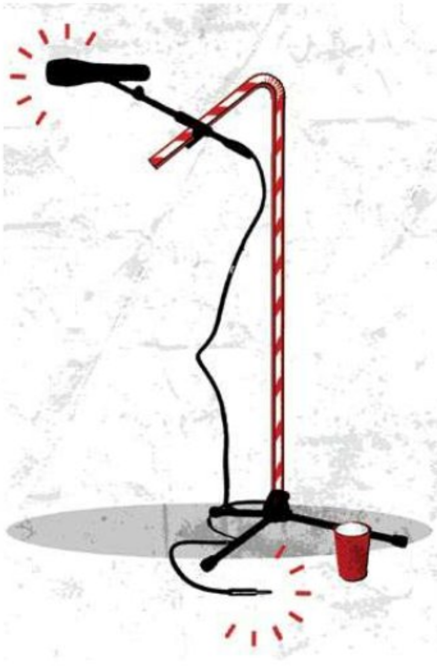
86%

Percentage of cosmetic surgery patients who are working women

Data: American Society of Plastic Surgeons

PUTTING THE JINGLE IN *JINGLE BELLS*

For its holiday marketing campaign in London, Coca-Cola will sponsor street musicians (or buskers, as they're called in Britain) who perform in the city's vast Underground transport system. But the deal, which starts on Nov. 30 and runs until Jan. 4, has a kink to work out. Coke would like the singers to perform its theme tune *Holidays Are Coming* and other Christmas-related fare. Many of the Underground's 240-plus buskers, however—from classical performers to rap artists—are balking. "Not in a million years will I play some Coke jingle," Michael Ball, a 47-year-old jazz guitarist, told the *London Evening Standard*. "What a daft idea." Transport for London, which manages the Underground, says no singer will be required to perform a specific song. Coke, whose logos will surround the buskers, also says the jingle isn't "mandatory." Still, the soft-drink giant is talking with officials about "incentivizing" the musicians to offer holiday songs, including Coke's. That's one way to teach the world to sing. *–Mark Scott in London*



(TOP TO BOTTOM) PHOTOGRAPH BY WIN MCNAMEE/GETTY IMAGES; ILLUSTRATION BY GARY NEIL

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THE DANGER IN TYING THE FED'S HANDS

Near term, inflation is under wraps. Down the road, however, the Fed's credibility as an inflation fighter could suffer if Congress exerts control over monetary policy—and that spells trouble

How much should we worry about inflation? In the coming year, nearly all economists say "not much." With so many workers and production facilities likely to remain idle next year, Econ 101 tells you the pressure on wages and prices is down. Looking beyond next year, though, the question is beginning to take on greater weight, especially amid recent congressional challenges to the Federal Reserve's authority and independence in conducting monetary policy.

The Fed's basic task is already herculean. Over the past year, excess reserves in the banking system, which determine the economy's money-creating potential, have soared to nearly $1 trillion, up from a comparatively trivial $2 billion or less before the financial crisis. Deciding when to start neutralizing this excess without either killing the recovery or breeding inflation will be hard enough. The Fed's increasing unpopularity on Capitol Hill adds another layer of difficulty. It may well have to begin tightening policy next year with unemployment at a very high level, something that would not go over well with such a hostile Congress.

5.5%

The annual inflation rate for imported goods (minus fuels) over the past three months, a 14-month high

Data: Labor Dept.

More important, the Fed's credibility as an inflation fighter, which is crucial to its ability to make effective policy, may be at risk. Legislation coming out of the House Financial Services Committee, innocuously called the Federal Reserve Transparency Act and supported by two-thirds of the House of Representatives, would subject the Fed's decisions on monetary policy to congressional audit. That is, if Congress doesn't like the Fed's decision to hike rates amid high unemployment, it can forcefully and publicly challenge all members of the Fed's 12-person policy committee.

Any perception in the global financial markets that political pressure is influencing monetary policy would raise expectations of future U.S. inflation, which would push up interest rates and add downward pressure on the dollar. Rock-solid inflation-fighting credentials are the chief reason why the Fed has been able to run a wildly expansionary policy while keeping long-term interest rates low and avoiding a collapse in the dollar.

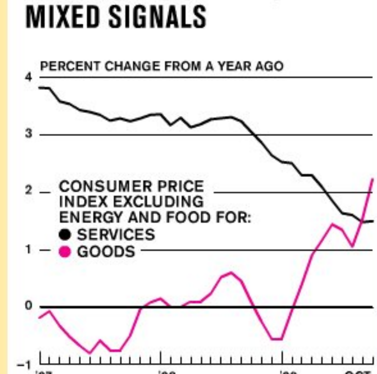
Concerns about inflation expectations, a crucial component of long-term rates, are central to the debate within the Fed over when to start tightening. The Fed's anti-inflation hawks are not thinking about inflation in 2010, but longer-term. They fear that an extended period of ultra-easy money could fuel the anticipation of rising prices. Such expectations can stoke actual inflation if they become deeply ingrained in business and consumer behavior.

Plus, the issue of underutilized labor and facilities is not cut and dried. Inflation hawks note that the jobless rate and operating rates can give misleading readings on the amount of slack in the economy, as happened in the 1970s. Technology and outsourcing may have rendered many skills obsolete, putting more upward pressure on the wages of workers with skills in need. And equipment is now wearing out faster than it is being replaced, thanks to sharp cutbacks in capital spending by businesses. That would imply a higher utilization rate that could create spot shortages and upward pressure on prices.

In fact, not all inflation measures are falling. Although core consumer inflation, which excludes energy and food, is declining in the broad services sector, goods inflation is running at the fastest pace in 16 years (chart). For now, the markets perceive little inflation danger, partly out of their belief in the Fed's anti-inflation resolve.

That perception will be important, given Washington's need for $2.8 trillion in new money over the next three years, based on Congressional Budget Office projections. As San Francisco Fed President Janet Yellen noted recently, budget deficits don't typically cause inflation in advanced economies with independent central banks that pursue appropriate monetary policies. Right now, though, the Fed's independence and the appropriateness of its coming decisions are increasing uncertainties in the inflation outlook. |BW|

INFLATION IS SENDING MIXED SIGNALS



Data: Bureau of Labor Statistics, IHS Global Insight

BRAD TRENT; CHART BY DAVID FOSTER

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79%
of analysts say assuring data quality is their most time-consuming task.

Poor data quality costs companies an estimated
25%
of their operating budget.

Best practices in data quality can boost revenue by
66%

Foresight to drive profitable decisions based on correct, complete and credible information.

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NUMBERS

UNMISTAKABLE SIGNS OF LIFE IN WORLDWIDE M&A

By Tara Kalwarski/Charts by David Foster

Global dealmaking is recovering, with the pace of announced mergers and acquisitions now almost double the lows earlier this year. North American companies have been the biggest targets. Morgan Stanley has surged into first place among deal advisers.

A High Bar: At its height in mid-2007, mergers-and-acquisitions activity was more than three times its current rate.

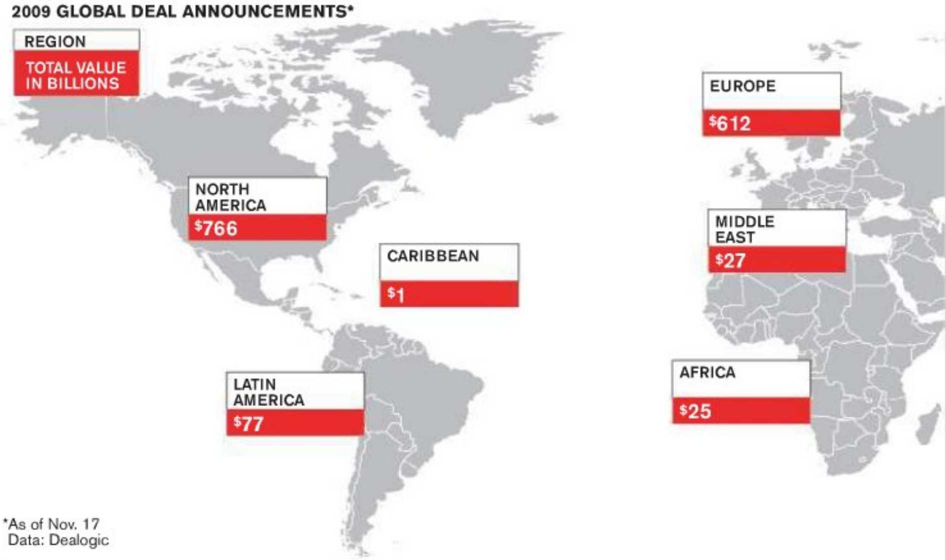


Data: Bloomberg

WHERE THE ACTION IS

Almost $2.1 trillion in deals have been announced so far this year. The map shows the total deal value by region of the targeted companies.

2009 GLOBAL DEAL ANNOUNCEMENTS*



*As of Nov. 17
Data: Dealogic

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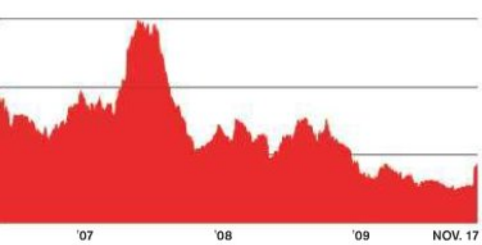
Lower Markups: The richest premium currently offered on $1 billion-plus deals is roughly 35%.

ANNOUNCED DEALS WITH THE LARGEST PREMIUM OFFERS*

TARGET	COUNTRY	ACQUIRER	COUNTRY	DEAL SIZE IN MILLIONS	ESTIMATED PREMIUM**
Skanditek Industriforvaltning	Sweden	Bure Equity	Sweden	1.7	34.6%
CF Industries Holdings	U.S.	Agrium	Canada	3.3	20.3%
RPG Cables	India	KEC International	India	1.2	14.6%
Iberia Lineas Aereas de Espana	Spain	British Airways	Britain	2.1	14.4%
Sun Microsystems	U.S.	Oracle	U.S.	5.7	10.5%

*Among global deals involving publicly traded companies with market caps exceeding $1 billion
**Calculated using current share price and per share offer value

Data: Bloomberg

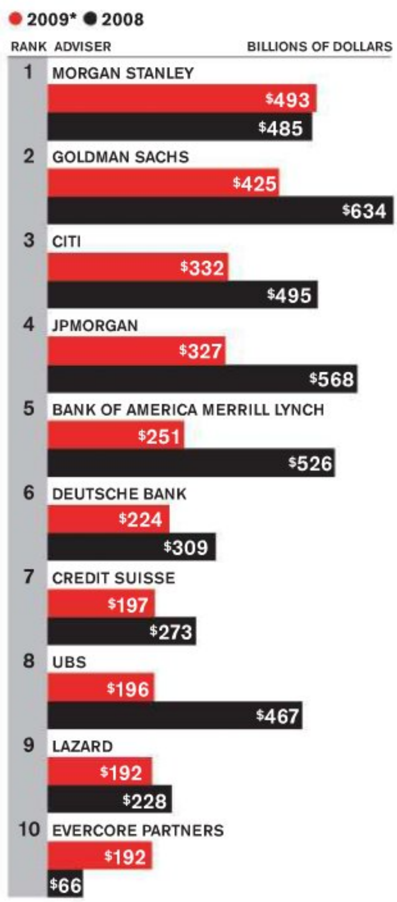


*Rolling 90-day sum



Top Dealmaker: Morgan Stanley, the No. 1 adviser so far this year, ranked fifth in 2008.

ANNOUNCED GLOBAL DEALMAKING BY ADVISER



Data: Bloomberg

*As of Nov. 17

91%
of the top 100 on the 2008 FORTUNE Global 500® use SAS – and that puts you in good company.

33
years of growth and stability as a privately held software company means we focus on you… not the next rumored merger.

22%
of revenue devoted annually to R&D is an investment in your future.

Foresight to thrive in an economic downturn.

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028 Hulu faces hard choices
029 Mumbai's amazing comeback

THE SLOW ROAD TO JOBS

In recent recessions, employment has taken longer and longer to return. Why this lag may be the longest

By Jane Sasseen

Could it take as long as five years for the economy to replace all of the 8 million jobs lost since the Great Recession began? The most bearish economists think so.

Job creation is proving to be painfully slow, and Washington is starting to panic. With unemployment at a 26-year high of 10.2% and climbing, the Democrats are scrambling to rev up the economy before the midterm elections next November. The latest effort is a "Jobs Summit" set for Dec. 3 at the White House. The idea, said President Barack Obama after a Nov. 23 cabinet meeting, is that the gathering of business leaders, nonprofits, academics, and labor will "explore how we can jump-start the hiring that typically lags behind economic growth."

That may well prove an impossible goal since the White House is battling an ominous economic trend that has been gathering in strength and severity for decades. The U.S. economy, once the greatest job-creation machine in the world, has taken longer and longer to replace the jobs lost in recent recessions—never mind creating the additional jobs needed to absorb new workers into the market. Back in the '70s and '80s, it took as little as a year after a recession ended to add back the jobs that had disappeared. Yet after the eight-month downturn that ended in March 1991, it took 23 months. And following the 2001 dot-com bust, 39 months passed before the U.S. returned to square one on the jobs front.

GDP is growing again, but most economists aren't predicting the kind of post-downturn spurt that typically drives job creation

This time, things could be even worse. U.S. payrolls peaked at 138 million in December 2007; today they stand at roughly 130 million. Stuart G. Hoffman, the chief economist of the PNC Financial Services Group thinks it could easily take another four years to regenerate all those jobs, assuming, as many economists do, that the recession ended in June of this year. David Rosenberg, the former top North American economist for Merrill Lynch, now with the Canadian investment firm Gluskin Sheff + Associates, is even more pessimistic. Convinced that the U.S. has now entered "the mother of all jobless recoveries," he believes it will take at least five years to recover all those jobs. "And that's a conservative estimate," he adds.

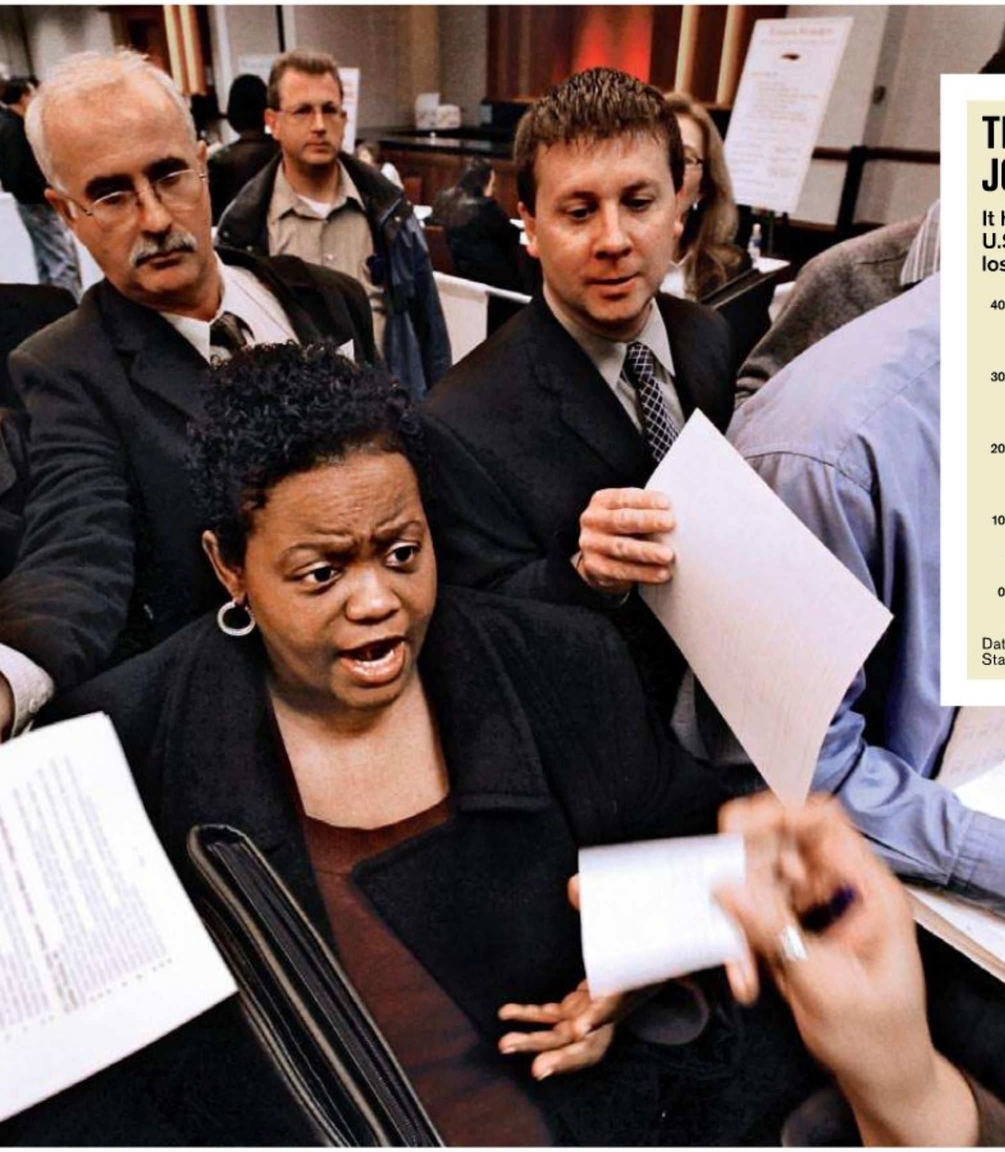
What accounts for the growing lag times? The speed and extent to which



Attendees at a job fair in Livonia, Mich., try to get their résumés into the right hands

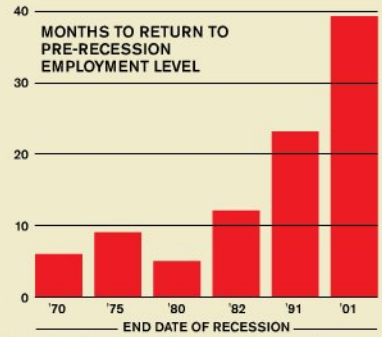
PAUL SANCYA/AP PHOTO: CHART BY LAUREL DAUNIS-ALLEN/BW

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THE RISE OF THE JOBLESS RECOVERY

It has taken longer and longer for the U.S. economy to re-generate the jobs lost in a recession



Data: U.S. Chamber of Commerce, Bureau of Labor Statistics, National Bureau of Economic Research

GDP bounces back after a downturn is one crucial factor. Martin A. Regalia, chief economist for the U.S. Chamber of Commerce, points out that as the U.S. recovered from earlier recessions, GDP often grew for several quarters at around 7%—roughly four points above the economy's long-term potential. Such spurts, fueled by strong pent-up demand among consumers and businesses, helped many unemployed Americans find jobs. Not this time: With both households and businesses stepping back from spending levels that were artificially pumped up by debt, demand is weak. Most economists project GDP growth to stay at or below 3% for the next to years. "If you don't have growth well above your long-term potential, you can't reabsorb people, so it takes a lot longer to get back to where you were," says Regalia.

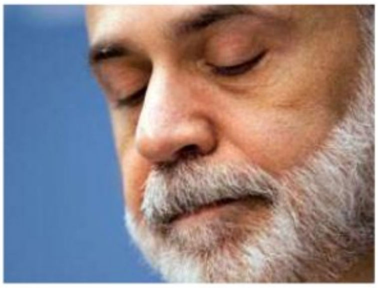
It's not just a matter of regaining lost ground: There are also all those young people just entering the labor force to put to work. Simply to keep the jobless rate from rising, the U.S. needs to add a net 150,000 jobs a month. While the slashing of U.S payrolls appears to be slowing, no one expects the economy to generate anywhere near the growth needed to generate that many new jobs anytime soon. That's why Harvard University economist Kenneth Rogoff believes the unemployment rate could peak at over 11%. "The U.S. would need to add a good 11 million jobs to bring the unemployment rate back to where it was at the start of the crisis, and over 9 million jobs just to get unemployment back to 6%," he says. As for the unemployment rates of 5% or lower that the U.S. boasted between 2005 and 2007? "We might not see that for a decade," says Rogoff.

Slower growth only partly explains the shift toward jobless recoveries. Goldman Sachs senior economist Ed McKelvey argues that over the last decade globalization and deregulation have forced companies to focus far more on controlling costs to remain competitive in world markets. Sharply higher productivity is allowing companies to get far more out of the workers they have, while factory automation is wiping out assembly line work and information technology is making many white- and pink-collar jobs extraneous. Meanwhile, companies are moving other operations abroad to take advantage of cheap labor in places like China and India. Such pressures from globalization are only increasing. "With most of the motivations and mechanisms for the jobless recovery still in place, we see no reason why most firms would behave differently this time around," McKelvey wrote in a recent note to clients.

In theory, American workers should be able to shift gears and perform higher-value-added work at home, and some have. But many Americans

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aren't equipped for the jobs of the future. A telling sign of the mismatch between workers' skills and employers' needs is that according to the U.S. Bureau of Labor Statistics, there were almost 2.5 million job openings in September that employers were actively trying to fill. While that was down from a peak of 4.8 million in 2007, it was still a stunningly high number considering that there were over 15 million people unemployed that month. Julian L. Alssid, executive director of the Workforce Strategy Center, says that schools, including many community colleges, still aren't producing graduates with the kinds of skills that employers demand.



Bernanke says part-time workers who want full-time work have doubled since '07

The weak labor market has left many workers far more idle than they'd like. That means companies have plenty of room to boost hours for part-timers before they need to add more people to the payroll. In a Nov. 16 speech, Federal Reserve Chairman Ben S. Bernanke pointed out that the number of part-time workers who want a full-time job but cannot get one has more than doubled since the recession began. The average workweek for production and nonsupervisory employees has fallen to 33 hours, the lowest level of the postwar period. "The best thing we can say about the labor market right now is that it may be getting worse more slowly," Bernanke added.

Which leads to another key reason why unemployment is likely to rise even as layoffs fade from the picture: New hiring will probably remain sluggish. That may seem an obvious point, but Michael Feroli, an economist with JPMorgan Chase, points out that the recent jobless recoveries didn't occur because layoffs continued longer than during a traditional recession. A far more critical factor was that businesses waited longer to start hiring again than had historically been the case.

The best ways to get businesses to start hiring again are all costly ones, and the fast-rising deficit may put them out of reach

It all adds up to an enormous economic and political challenge for President Obama and his advisers—and one for which they have only limited ammunition. Count on the President to keep reminding everyone how much worse things would have been without the stimulus and the bailout of the banks. While there's talk of boosting infrastructure spending and offering tax credits to employers who create new jobs, the soaring deficit is likely to prevent ambitious new programs from being adopted. "There aren't a lot of easy options," warns Gregory Valliere, chief policy strategist for institutional broker Soleil Securities. "Those that make the most sense will cost a lot of money, which voters have adamantly rejected. So it's hard to see what they can get done." The real question may be whether the summit gives the Administration and its congressional allies some political breathing room. |BW|

–With Peter Coy

MORE IDEAS FOR CREATING JOBS

Government has thrown a lot at the unemployment problem already, from near-zero interest rates to a $787 billion fiscal stimulus, with limited success. Here are some of the other ideas in circulation.

PAYROLL TAX CUT

Some economists estimate that temporarily cutting Social Security payroll taxes roughly in half would increase employment by 3 million to 4 million workers by making it cheaper for employers to add staff. But such a cut would worsen Social Security's long-run financing problems. And if sales are weak, employers still might not add jobs.

TAX CREDITS FOR NEW JOBS

These credits would be more targeted and efficient than an across-the-board payroll tax cut, because benefits would go only to employers who added to payrolls. It worked in the 1970s. Still, there's no guarantee that employers will hire if demand stays weak. And critics say many subsidies would go to employers who would have hired anyway.

INFRASTRUCTURE SPENDING

Brookings Institution economist Gary Burtless favors Depression-style spending on long-term public works projects, assuming the jobs market will need support for years. Such projects would create assets of enduring value like dams and schools. Downside: Relatively few jobs per dollar spent, plus it may take a long time for work to turn up.

JOB SHARING

Liberal economists favor sharing the pain by cutting workers' hours so it takes more employees to get the work done. This appeals to some people's sense of fairness. But it's costly for employers and the evidence from France and other European nations is that it doesn't increase employment.

REGULATORY ROLLBACK

Conservative economists say the free market will create jobs soon enough if trade were expanded and distortions such as costly regulation, too-high minimum wages, and extended unemployment benefits that discourage job-seeking were ended. Trouble is, with demand so soft, it's not clear such steps would increase employment.

ANDREW HARRER/BLOOMBERG

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BEHIND THE GREAT STOCK RALLY OF 2009

There may not be much beyond herd-like momentum, but it could keep the market going even into next year



By Roben Farzad and Tara Kalwarski

The U.S. economy is coping with alarmingly high double-digit unemployment, a widening commercial real estate bust, and over-indebted consumers. Few think the economic recovery now under way will be a spectacular one in 2010. So why has the stock market surprised skeptics by powering higher in recent weeks? One explanation being bandied about by equity strategists and portfolio managers is that the stock market may be in the midst of a momentum-driven trading phenomenon known as a "melt up" that has precious little to do with economic fundamentals.

A melt up is a rapid and mass rush by investors into an asset class after a belated realization by market players that worthwhile gains are to be had there. Part herd mentality, part self-fulfilling prophecy, this trading behavior is amplified by the age-old tendency of fund managers and retail investors to chase returns in the hopes of making up for lost time and lagging performance. The U.S. stock market is enjoying an explosive rally that has humbled plenty of bears, who have been predicting a deep correction for several months now. Instead, the Standard & Poor's 500-stock index has soared 63% since its Mar. 9 low and is up 22% for 2009.

WHERE'S THE SUPPORT?

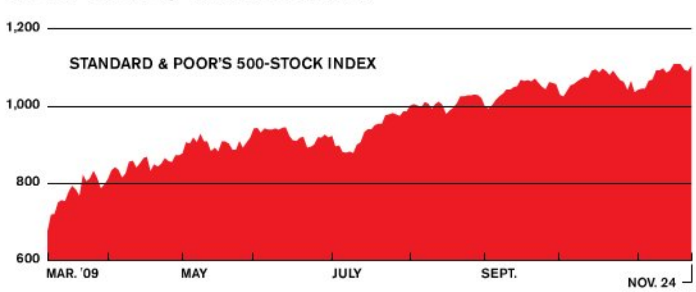
That has left plenty of money pros rethinking their market outlook. "We've spent a considerable time of late assessing the conditions for a melt up," admits Bernie Schaeffer, chief executive of Schaeffer's Investment Research. He says he is baffled at how the market's rally this year has essentially been devoid of improved investor sentiment and big inflows into domestic equity funds. While bond funds have taken in nearly $330 billion so far this year, U.S. stock funds have lost almost $28 billion. A handful of big institutional investors and hedge funds, rather than retail investors, have been responsible for the lion's share of buying this year.

In fact, overall there is far greater investor enthusiasm for asset classes other than U.S. equities. Emerging markets, which have outperformed their American counterpart, are being deluged with fresh money. The red-hot junk bond market is also attracting heavy investor interest. Even gold coins are being hoarded as the yellow metal keeps breaking records.

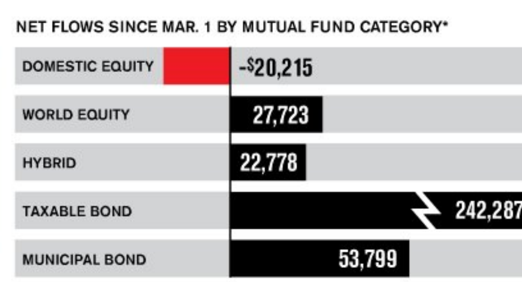
Mom-and-pop investors in U.S. stocks, meanwhile, are only slightly less bearish than they were in March, when the market hit a 12½-year low. Yet that could change, given the

UNREAL REBOUND?

The S&P 500 is up 63% since March...



...but the bulk of cash has gone into bonds.

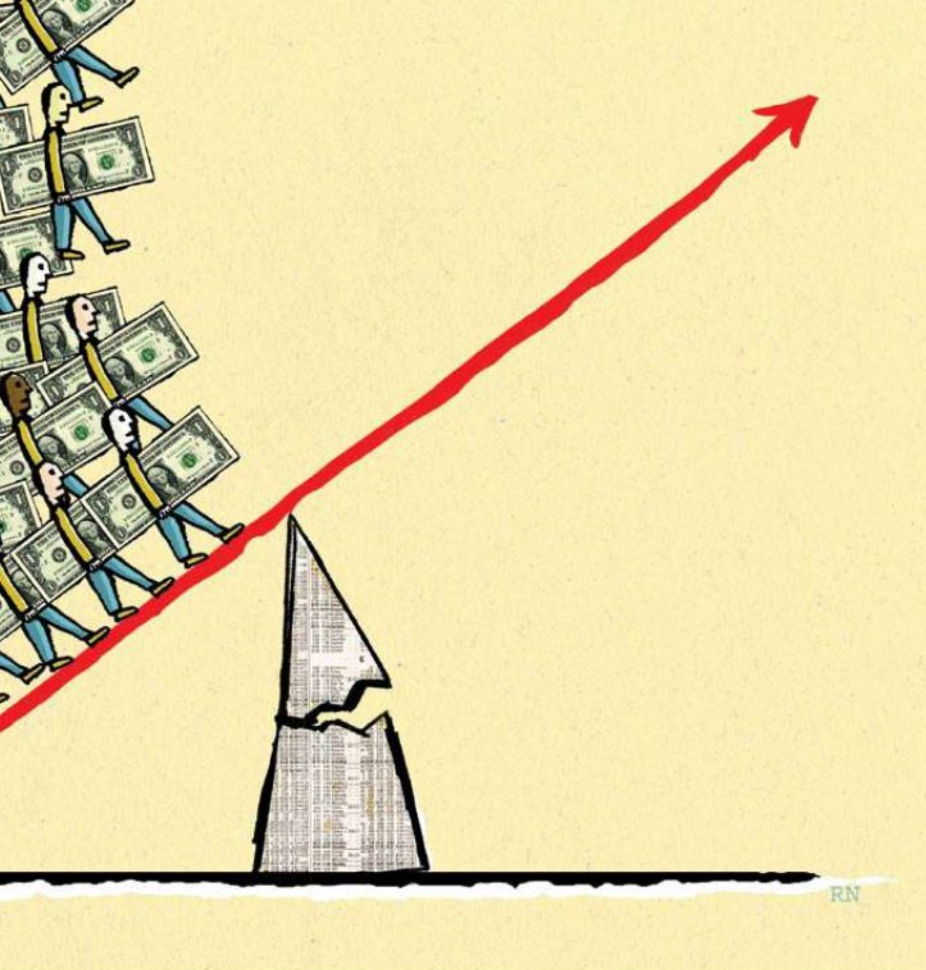


Data: Bloomberg, Investment Company Institute

*As of Nov. 11; in millions

ILLUSTRATION BY ROBERT NEUBECKER; CHART BY DAVID FOSTER

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impressive performance this year in the S&P 500 and Nasdaq Composite Index, up about 38% in 2009. "If 2010 starts out strong as well," says Schaeffer, "the fear of missing out on stock returns could prove irresistible." Not coincidentally, January happens to be high season for personal finance introspection—with outsized attention paid to the past year's performance column and the coming year's retirement account funding.

A bigger and more pronounced money shift into stocks early next year could be also induced by diminishing returns in many segments of the bond market. There is every indication that investors are scraping the bottom of the fixed-income barrel. Three-month Treasury bills, that redoubt of ultraliquidity and safety, are yielding just 0.03%. A negative yield, where people actually pay the government to safeguard their money, could be in the offing. On the other end of the curve, the 10-year Treasury note yields 3.3%, a rate that skeptics argue does not begin to buffer holders from the real risk of inflation a few years out.

The Federal Reserve doesn't just slash short-term interest rates to help banks; it does so to make sitting on cash painful enough to force investors back into the risk-reward economy.

"The pressure to finally commit [to the market] will be on, whether managers like it or not," says an industry watcher

Which might not be that difficult an undertaking if there weren't so much idle cash out there—a remnant of last year's panic and subsequent spate of bank failures and bailouts, the likes of which made "return of money" out-prioritize "return on money."

After nearly touching $4 trillion in January, money fund assets were last clocked at $3.339 trillion, according to the Investment Company Institute. Barring another crisis, the hunt for yield will prompt more drawdowns from this sizable balance and perhaps shift more funds into stocks. "What I'm expecting is people being forced to get in," says Peter Grandich, a veteran investor newsletter editor. "The vast majority of money is managed by professionals who are gauged and measured on performance, a lot of which is judged by the quarter," he adds. "In 2008 people yelled at them for not getting them out; in 2009, people are getting yelled at for not getting in. The pressure to finally commit will be on, whether managers like it not."

Of course, melt ups—like so many trends that involve investor psychology and behavioral economics—are, by definition, almost always unpredictable. Who is to say that investors haven't been rendered so skittish by the repeated heartbreaks from U.S. stocks that they would make their bets on companies in China, Brazil, and beyond before getting reacquainted with Citigroup, General Electric, and Microsoft? Or that the full-fledged return of the individual investor, should it come, to the Dow, S&P, and Nasdaq wouldn't actually be a red flag for the smart money to bail?

Indeed, the last time financial pros talked of the prospect of a melt up was in early 2007, when buyout shops were snapping up companies left and right and hedge funds were putting everything else in play. Money was cheap; risk seemed overrated. So much so, in fact, that the prevailing worry then was that investors would realize there simply wasn't enough stock to go around to accommodate the flood of buy orders that were supposed to prompt a renaissance for the American stock market. It all ended in tears, of course. Wall Street cratered and took the world economy down with it.

Few are predicting a reprise of the U.S. and global market collapse of 2008 that destroyed trillions in wealth around the world. Yet until this rally attracts a broader base of investors and is supported by robust economic fundamentals instead of short-term trading strategies, it is hard to see a multiyear bull market taking hold. |BW|

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MURDOCH VS. GOOGLE

In a challenge to Google, News Corp. may make a deal with Microsoft—unless regulators feel differently

By Douglas MacMillan

In a bid to loosen Google's dominance over online news, News Corp. Chief Executive Rupert Murdoch is talking with Microsoft about making his company's content available exclusively through the software giant's Bing search engine. But any deal to keep stories from *The Wall Street Journal* and other papers out of Google search results could do more harm than good for Murdoch and Microsoft.

Murdoch is considering a pairing with Bing because he believes Google benefits at the expense of his own media outlets. He argues readers often scan story excerpts on Google News without clicking through to newspapers' Web sites, robbing them of ad revenue. But acting alone, News Corp. may not have much impact on Google's share of the search market, 65.4% in October. Murdoch would likely need substantial backing from other newspapers. "It would take a great proportion, most all of the industry, to do something together," says Jim Moroney, executive vice-president of A.H. Belo, publisher of *The Dallas Morning News*, which is also considering giving a single search engine access to its news. Google has said any Web site can opt out of search results by adding a line of software code to its pages.

But regulators might look askance at publications acting in concert to dump Google. "This would raise significant antitrust issues because competitors would be agreeing to limit their competitive conduct in an important respect—delivery of their service to the public," says Sam Bayard, assistant director of Harvard's Citizen Media Law Project. Representatives of News Corp. and Microsoft refused to comment on the prospect of a deal.

A move to secure Bing as the only search engine able to deliver WSJ content could strike regulators as anticompetitive

Murdoch would need tremendous industry help to break Google's hold on news

As part of the proposed plan described by insiders, Microsoft would pay a fee in exchange for making Bing the only search engine able to deliver content from the *Journal* and possibly other News Corp. media. Regulators may consider those payments an attempt to trammel competition in the lucrative online search market, says David Balto, a senior fellow at the Center for American Progress and a former antitrust official with the Federal Trade Commission. "That kind of exclusionary practice will certainly catch the attention of the antitrust cops," Balto says. "It's depriving consumers of choice." He says the moves would be reminiscent of now-outlawed agreements that made Microsoft's Windows the sole operating system available on whole fleets of computers in the 1990s.

Another risk is that walling off WSJ.com and other publications from Google would slash traffic to News Corp. sites and make the company beholden to Microsoft to compensate for any decline in advertising. "Being dependent on a giant company for a large share of your revenue is very shortsighted," says David Hallerman, senior analyst at researcher eMarketer. Google accounts for 26.3% of traffic to *The Wall Street Journal* alone, according to data tracker Experian Hitwise. Some analysts say Murdoch may be talking tough now to get a better deal from Google to supply advertising on News Corp.'s MySpace.

If he really wants to lead newspapers away from Google, Murdoch would have to persuade other media outlets to stomach an immediate decline in online readers. Most of the members of the Newspaper Association of America rely on Google for about 30% of their online traffic, says Randy Bennett, senior vice-president of business development for the industry group. They would "think long and hard before they just move their listings wholesale to Bing." |BW|

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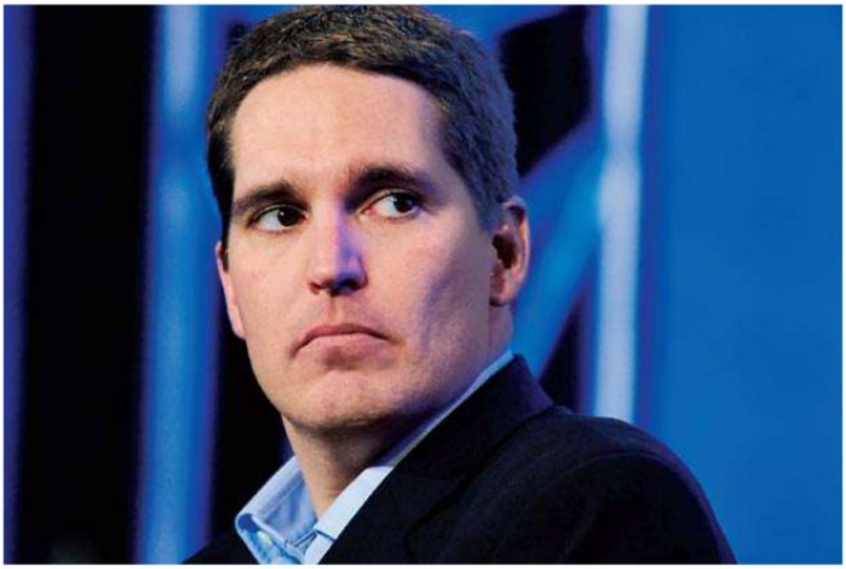
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HULU'S TOUGH CHOICES

Viewers love the site's free shows, but it's losing a bundle and may soon have to start charging



Hulu's Kilar: A price tag on his videos could drive viewers to other Web sites

By Ronald Grover

Since its launch in late 2007, Hulu has pretty much defined the Old Media vision of video on the Web. Each month the site's 1,700-title catalog of TV shows and movies attracts nearly 40 million viewers—people who will endure a couple of commercials per sitcom (vs. eight or more on TV) in exchange for the luxury of being able to watch a show for free, just one day after it airs on network TV.

Those days may now be coming to an end. NBC, Fox, and ABC, the broadcasters that control Hulu, are warming to the idea of charging for at least some content. Hulu is expected to start testing subscription tiers for its programs in the new year, according to those who have worked with the Los Angeles company. And *BusinessWeek* has learned that Hulu is in early-stage talks with cable operators, including Comcast and Time Warner, to limit access to those viewers who can prove they already pay for a cable subscription. That would be a big concession to the cable companies, which worry that sites offering free TV shows and movies will prompt folks to drop their cable subscriptions. A Hulu spokeswoman declined to comment on the talks.

Another option for Hulu would be to limit service only to people who are already cable or satellite subscribers

It's not hard to see why Hulu's owners are willing to risk sacrificing their baby's explosive growth in eyeballs. The site may be No. 2 after YouTube in number of videos streamed, according to comScore, but analysts expect Hulu to lose $33 million this year. "Hulu was a great way to explore and learn about what was happening with video online," says Mark Cuban, who owns the cable channel HDNet. "But it has run its course."

DISNEY'S CUT

The betting among analysts is that sooner or later Hulu will ditch its open model in favor of a closed one. Most likely, they say, the site will be made available only to paying cable and satellite subscribers under a model the industry has dubbed TV Everywhere. Comcast intends to roll out a version of such a service by Jan. 1 for all its 24 million subscribers. Called On Demand Online, it will allow subscribers to view shows online by entering a password, and several cable channels have signed up to provide programming. But so far just one broadcaster, CBS, has come on board—and only for a test of how the service's authentication technology would work.

At least one Hulu partner would like things to stay the way they are. That's Robert A. Iger, CEO of Walt Disney, which became an investor in Hulu in May. Disney, which is ABC's parent, wants to keep letting people watch the network's shows for free on Hulu. Yet if cable companies want to offer ABC's programming through online services such as Comcast's On Demand Online, Disney wants its cut, Iger says. "When you provide more convenience, you should be able to charge for that—and charge an appropriate amount," he recently told analysts.

As Hulu's partners struggle with their differences over business models, Jason Kilar, the site's CEO, has been exploring a variety of options for boosting revenue. "There is no single silver bullet," he said in an August interview. But, as failed online sites have learned, charging for what was once free can cause online traffic to dive. "The issue," says analyst David Joyce of Miller Tabak, a securities trading firm, "is how Hulu [will] put the genie back in the bottle after consumers have enjoyed getting TV shows for free." |BW|

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Bullet holes pockmark a wall across from Mumbai's Jewish Chabad House

PRASHANTH VISHWANATHAN/BLOOMBERG; CHART BY DAVID FOSTER

LETTER FROM MUMBAI

A SHAKEN CITY REVIVES

Amid tightened security since terrorists killed 166, India's business hub is thriving once again

By Mehul Srivastava



A year after the terrorist attacks that brought Mumbai to its knees, India's financial capital has reverted to form, with shops and restaurants humming, bankers again throwing money around in pubs and clubs, and beggars thronging the streets. Yet there's a malaise brought on by heightened security, a lingering sense that the city remains a target.

Champagne brunches are interrupted by bomb-sniffing dogs. Brides are frisked as they walk from their cars to their weddings. At the Taj Mahal Palace hotel—the epicenter of the attacks—guards are on constant alert, earpieces in place even when they're trading cricket scores. As I pass through the metal detectors there, I am frisked, questioned, and followed, my backpack and bushy beard ringing instinctive alarms. "We've got 500 cameras all over South Mumbai, 29 patrol cars, 1,500 high-powered rifles," says Deven Bharti, a police official. "We've done a lot of things that are invisible."

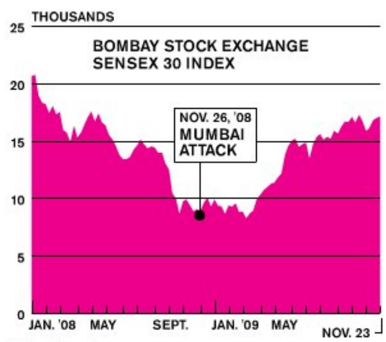
Easier to spot are the physical reminders of the 60 hours last November when a band of 10 Muslim terrorists laid siege to Mumbai, killing 166. But the tragedy has morphed into a spectacle. At the Leopold Cafe—where the first shots were fired—foreigners jostle for the front tables, putting their fingers through the bullet holes still in the windows. Outside the Jewish Chabad House, the 107 spots where gunfire hit the wall are marked with red ink. In the lobby of the Taj, the house pianist plays *Strangers in the Night* and an American in a Bernie's Steakhouse T-shirt asks me, "Dude, this is where they killed those people, right?" Outside, a barefoot boy hawks the latest toy, a six-inch soldier crawling on his belly, cradling a rifle in his arms. "Bang, bang," the boy says. "Eighteen rupees, sir."

To an outsider, the speed with which the city has returned to normal may be disconcerting. But to those who call Mumbai home, the fact that the trains were running a day after the attacks, that the Taj reopened the next month, that the stock exchange has since soared—these all affirm the city's spirit. "People who live and work in the city of Mumbai, they've dealt with adversity before, with terror before," says Ajoy Misra, marketing chief for Tata Group's Indian Hotels, which runs the Taj. "It makes us tough. It gives us discipline."

As Mumbai has bounced back, though, so have its familiar divides. In the weeks after the attacks, the city mourned as one. Now, as before, the rich thrive and the poor barely survive. Late one night, I visit the Gateway of India, a classical arch built in 1911 to welcome King George V. The air on the Arabian Sea waterfront smells of garbage and salt. The sudden scratch and bright light from my cigarette lighter startle a policeman, who quickly grabs his ancient rifle. "We sleep here," he says, pointing to the sidewalk beneath the arch. Nodding toward the Taj, he says, "They don't even let us use the toilets in there."

Not far away, the wealthy throng Tote, a new nightclub so exclusive I can't beg my way in. I recognize a banker as he steps out of his Italian sports car. He manages to get me in the door, and soon his girlfriend is spraying us with Champagne. They're celebrating because his bank will represent Reliance Industries in its quest to buy chemical maker LyondellBasell for as much as $12 billion. "You know what those f------ terrorists don't understand?" the banker says, his cheeks red from too much booze. "You can't destroy money. And that's what this f------ city is." |BW|

REBOUND



Data: Bloomberg

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LOOK WHO'S STALKING WAL-MART

Target is increasingly going downmarket to get through the consumer recession. But can it ape its rival and retain its cachet?

By Michelle Conlin

Photograph by Matthew Gilson

At a Target store, the visual sizzle usually comes from the photos of all the fabulous-looking people wearing fabulous clothes and doing fabulous things. Of late, though, there's an entirely new vibe—supersize signs screaming dirt-cheap prices. Past the cashiers is something else unmistakably novel: a sleek Euro-style mart carrying fresh cuts of sirloin, cheery piles of fruit, and hormone-free dairy.

The lowest prices on the planet! Plus a grocery store. Wait. Doesn't that sound an awful lot like Wal-Mart?



Target reinvented American retailing. By democratizing design, it rescued the family budgeter from the aesthetic provinces of dinette sets and acid-washed jeans. Target was one of the first to use famous fashion designers to cast a halo over its brand and draw people into its stores. Before long hipsters had dubbed the retailer "Tarzhay," and everyone from J.C. Penney to Wal-Mart was ripping off Target's cheap-chic playbook.

Now the charge is that Target is copying its archrival, and its executives are bristling. They insist they provide a superior store experience. Nor have they any plans to abandon their 15-year-old slogan: "Expect more, pay less." "We're not trying to be anyone else," says Chief Executive Gregg W. Steinhafel. "We're working hard to convey both sides of our brand."

All the same, a kind of role reversal is under way in Retail Land. Wal-Mart has long borrowed from Target. Now Target is stalking Wal-Mart. Target's magic has always been about pushing its low-cost business model relentlessly upmarket. But to get itself through the Great Recession, it appears to be going downmarket. Some critics say the strategy smacks of desperation. Others, pointing to a rebounding stock price and better-than-expected earnings last quarter, believe the strategy may be working. The challenge for Steinhafel is to compete on price without losing the Target twist.

Steinhafel's ascension as CEO in May 2008 represented mostly a change in style rather than substance. His predecessor, Bob Ulrich, the press-allergic, cowboy-booted visionary who made Target a retailing juggernaut and cultural

GRAPHICS BY SHAKENA THORNTON/BW

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CEO Steinhafel: A new marketing strategy and an aggressive move into groceries



phenomenon, was known as an authoritarian. Meeting with him, says one executive, was "a sphincter-tightening experience." (Ulrich was unavailable for comment.) Steinhafel, by contrast, is a leader people can rally behind. During nine years as president, he became known as Target's nice dad. So while he was expected to change the tone at Target, he wasn't considered likely to deviate much from his predecessor's modus operandi. After all, it was working.

Until it wasn't. The economy imploded, Americans stopped shopping, and Steinhafel found himself confronting a different world. "This was a wake-up call," he says. "We had to do a lot of soul-searching." It didn't help that as the news flashed pictures of Lehman Brothers employees carrying boxes out of their offices in September last year, Target was rolling out pop-up stores selling 22 new things from 22 new designers. The pop-ups, which came and went in four days, were in the works long before the crash and did well. But for the first time, Target seemed out of touch. Wal-Mart, with its megajugs of cheap contact lens solution, seemed prescient by contrast.

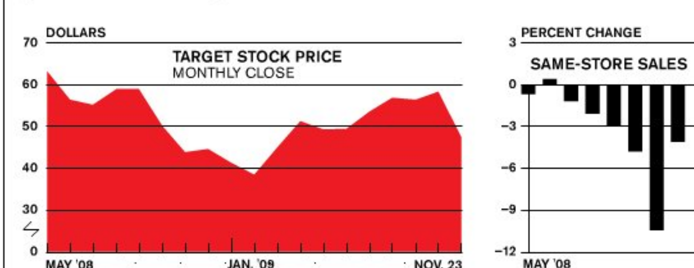
EXTREME MESSAGE MAKEOVER

At Target's Minneapolis headquarters, Steinhafel turned his airy offices on the 26th floor into a war room. The data pouring in were shocking: Sales at stores open more than a year were falling 3%, then 5%, then 10%. As the stock slid and slid, says Jefferies managing partner Daniel Binder, people were asking: "Is there something wrong here with Target that has changed structurally?"

Target had long emphasized the first part of the "Expect More, Pay Less" equation. Research showed consumers perceived Target as pricier than Wal-Mart, when in fact they were only a few cents apart on most items. Given the state of the economy, stressing "Pay Less" seemed eminently rational. Yet Steinhafel hesitated. If he pushed too hard on price, would he lose what made Target "Tarzhay," upending a strategy Ulrich spent 20 years perfecting? Would Target—God forbid—start to look like Wal-Mart? "That's why they were reluctant to do it at first," says Telsey Research chief Joe Feldman. "They don't want to be Wal-Mart."

Steinhafel, however, soon saw that American consumers might never return to their free-spending ways. It was time to start making a big deal about low prices.

STEINHAFEL'S WILD RIDE



Data: Bloomberg, Jeffries & Co.

With sales in free fall, Steinhafel needed to move fast. Fortunately, Target is a quick executor. In big-box retail circles, the company is legendary for its ability to tear down and rebuild stores in less than nine months. Inside Target, the store rehab process is called Phoenix. Steinhafel needed to pull a Phoenix on marketing. His partner in this extreme message makeover was Michael Francis, the natty chief marketing officer. Francis draws his marketing philosophy from the 1952 book about retailer Marshall Field, *Give the Lady What She Wants!* "It's all about making sure we know who the lady is and making sure we know what she wants," says Francis.

That "lady" is a working mother in her 40s. And over the years Target has spent tens of millions of marketing dollars appealing to her. In TV and print ads, it has long cast her as the hip hero in her own life. (Even her own kids think she's cool.) But as Francis scoured his charts and graphs late last year, he could see that the Target fashionista was turning into a frugalista. "She wasn't seeing herself in the shiny, happy people advertising," he recalls. "It was no longer aligned with what she was dealing with in her life." The trick was to focus on low prices without making Target's target customer feel cheap.

Francis and his team hit on a marketing strategy in which Target essentially plays the empathetic personal shopper. In highly produced two-minute Webisodes on Target's site, *Marie Claire* fashion director Nina Garcia mentors frayed, broke moms on how they may feel poor but can still look rich. In the show, a riff on TLC channel's *What Not To Wear,* Garcia teaches shoppers such as "Katie" how to be "frugalista fabulous." We see Katie—who has no winter coat—looking fierce in a double-breasted topcoat ($59.99), a classic peacoat in red ($40), and a motorcycle jacket ($29.99). "Ooo la la," says Katie as she twirls in a Lanvinesque gray cape ($44.99).

BILL CRAMER/WONDERFUL MACHINE; CHARTS BY DAVID FOSTER

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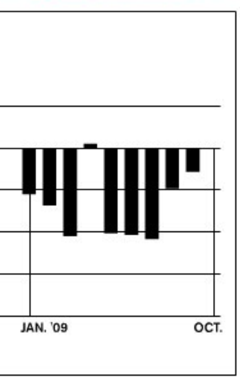


Target hopes more food choices will bring shoppers to its stores more often

For years, Target has focused on the aspirational image of the designers behind its apparel. Now, Francis decided, the company would highlight the notion that good value can be chic, too. This fall, for example, Target introduced designer Anna Sui's collection, starting at $19.99, based on her favorite television show, *Gossip Girl*. The ads show a grainy, cinema verité New York City with waifs sashaying down the runway in Bohemian glam. Then Sui's voice over: "Anna Sui. Prices to gossip about."

FILLING THE PANTRY

Steinhafel's decision to move more aggressively into groceries represents an even tougher challenge. Wal-Mart has been selling food for years, using groceries to boost store traffic. But selling food is a difficult, low-margin business, and Target has refrained from pushing as hard into groceries as its rival. So while Target has long sold food at its 252 SuperTargets, its regular stores have carried mostly dry goods, cans of soup, and jars of peanut butter. Yet the retailer was desperate for traffic. And Steinhafel couldn't ignore two facts. Target's working-mom customer was obsessing not about thigh-high boots but about the price of milk. Plus, industry and in-house research showed she was popping into the grocery store twice a week but visiting Target only three times a month.



Last fall, Steinhafel began testing a prototype grocery that sold fresh food, which typically commands higher margins than packaged groceries. The company commandeered part of an existing store and quickly turned the space into a sleek, rock-bottom-price grocery with everything one could possibly need to fill the family pantry. The rollout was done stealthily, with almost no publicity. Before long, the food marts were lifting sales at test stores an average 5% to 10%.

When retail chains launch a concept, they usually back it up with a national advertising campaign. But often the items are available only at "select stores." With this effort, Target is going hyperlocal. Instead of a gradual rollout across the U.S., it focused on one market, Philadelphia. In September it began putting food marts in all 30 urban Philly stores. Once they were ready to go online in October, Target carpet-bombed the city with its message of "Fresh food for less green" and "Quality cuts, lean prices." The blitz was everywhere: e-mail, radio, newspaper circulars, TV, and what seemed like nearly every billboard in town. "If you don't know about it and you live in Philly, you have to be living under a rock," says Citigroup retail analyst Deborah Weinswig. By testing in a single market, Target was able to measure immediately the efficacy of the marketing. The results have been promising, with sales exceeding expectations. Steinhafel plans to roll out the concept to 350 more stores in 2010.

As Target's CEO and his executives take stock and look back on the past year or so, they regret not moving faster. "We may have been a bit slower than we should have been due to how rapidly the economy shifted and to our own advance planning processes," says Francis.

Still, the course correction seems to have helped stop the bleeding. On Nov. 17, Target said net earnings rose 18.4% during its third quarter, the first positive result in eight quarters. It also reported that its gross margins, excluding its credit-card division, rose to 30.8%, from 30.6% in the third quarter of 2008. Meanwhile, Target says its research shows consumers are starting to believe it is indeed competitive with Wal-Mart on price. "Based on our price checks, the price gap between Wal-Mart and Target is the narrowest it has ever been," says Weinswig. "They are now at price parity. But Target does it with a better customer experience." While Target did cut prices on some merchandise, its marketing onslaught is mostly responsible for changing consumers' perception.

Target usually doesn't hammer the price message during the crucial holiday shopping season. Now it does. The company is devoting 75% of its advertising budget to price, vs. 25% last year. Target is making a big bet this holiday season that people will be shopping for key must-have items and solution-oriented products. Door busters include a 32-inch flat-panel TV for $246, electronic hamsters for $7.99, and a $3 coffeemaker.

In truth, Target's focus on price and groceries looks less like strategy than a tactic to buy time. "They have to reinvent themselves," says Nigel Hollis, of the branding shop Millward Brown. "The 'pay less' strategy may not be the one, but at least they can hold their ground until they figure out the next big thing." The trick will be executing a me-too strategy without turning into You Know Who. As marketing chief Francis says: "The world doesn't need a second Wal-Mart." |BW|

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Japanese Standout

Most Americans have never heard of it, but Japan's Fast Retailing is intent on becoming a household name the world over. The clothing retailer's same-store sales soared 36% in November, reports Bloomberg. Growth has been led by Uniqlo, a chain of affordably priced casual-clothing stores, which in October unveiled a line of apparel developed in collaboration with high-fashion German designer Jil Sander.

To read more about Fast Retailing, go to **http://bx.businessweek.com/clothing-retailers/**

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WHY OLD NAVY MAY STILL BE AT SEA

Inside a foray into fashion, a bruising strategy switch, and a public breakup with designer Todd Oldham

By Susan Berfield

Photograph by Robert Galbraith

Two years ago, Old Navy decided to try to recreate itself with a strategy that has become almost routine in modern retailing: hire a celebrity designer to confer new prominence on an uninspired brand. In September 2007, the giant apparel chain announced that Todd Oldham, who had already worked with Target, would be Old Navy's design creative director and develop a collection under his own name.

At first Oldham seemed like just the kind of designer to give Old Navy an edge. He's quirky and fun, he likes bold, bright colors, and he has an all-American sensibility. Which is how most people would have described Old Navy at its most successful. But before Oldham was halfway through his three-year contract, the partnership came apart at the seams, as it were, and eventually he was fired. (He and the company have countersued one another over the breach, and a federal judge in Manhattan may soon decide if the case will go to trial.)

What happened? Gap, which owns Old Navy, won't talk about it. But people who were there at the time say internal disagreements, management turmoil, and tanking sales prompted the company to ditch its designer strategy for a back-to-basics one that was easier to execute in hard times.

The question now is whether Old Navy did the right thing. It is true that in recent months store sales have improved. On Nov. 19 the company announced that autumn sales had increased by 10% from the previous year, the first time the business has grown since the spring of 2004. But some industry watchers are dubious the back-to-basics strategy will work as well once the economy revives. "Old Navy lacks an identity now," says Robert Burke, founder of his own retail consultancy. "A retailer needs buzz. Saying you're basic puts people to sleep. Even if a retailer says it's affordable, it has to be interesting."

NO DESIGN HERE, THANKS

Since its founding in 1994 as a cheaper, more exuberant version of the Gap, Old Navy has been essentially a volume business. The retailer has some 1,000 stores that encompass almost 20 million square feet. Last year sales were $5.7 billion.

In a business like this, creativity is always tempered by pragmatism. Original design is not encouraged. Quite the contrary. Old Navy's designers practiced what they called competitive shopping: buying pieces from stores such as Neiman Marcus or Abercrombie & Fitch to show the season's trends. The company's all-powerful merchants—the more market-oriented executives—would look at the merchandise and decide what to adapt for Old Navy.

For a while, the strategy worked amazingly well. Old Navy made shopping on a budget fun for the first time: Its clothes were easy to wear without being utilitarian; its stores looked

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Wyatt: Focusing on the 25-to-35-year-old recession-weary mom

REUTERS

like old industrial lofts and sometimes featured DJs; its ads were campy. Five years after the first store opened, Old Navy's sales exceeded a billion dollars. But by the early part of this decade, other retailers developed their own approaches to cheap chic. The Swedish company H&M introduced its edgy clothes to America. Target brought in a new design aesthetic. Old Navy didn't change. Its clothes started to seem uninspired, its stores outdated. That could only last so long.

In late 2006 Dawn Robertson, an ambitious and forthright executive who had come up through the ranks at Federated Department Stores, joined Old Navy as president. She modernized the company, speeding up the time it took for clothes to go from drawing board to rack. The retailer was finally going to join the world of fast fashion. Robertson also decided to abandon Old Navy's focus on price-conscious moms, a group every other mass retailer was chasing. Instead, Old Navy would make clothes for young, fashion-conscious women.

To make that work, Old Navy needed to shake up its designers. Many other companies had already been there, collaborating with big names in fashion. Sometimes such tie-ups turned out to be nothing more than a lark. (Did you see Madonna's collection for H&M?) But others, such as Target's arrangement with Isaac Mizrahi, worked wonderfully. Robertson put out the word that she was looking to appeal to a younger, hipper crowd, and in the summer of 2007, Oldham visited the San Francisco headquarters to discuss a possible partnership.

Over the course of his career, Oldham, now 48, had moved from designing women's couture to creating dorm-room accessories for Target, designing furniture for La-Z-Boy, and hosting a show on Bravo. He was eager to try fast fashion and was reassured by how serious Gap was about bringing a new sensibility to Old Navy. "I was asked to join a company whose focus was to clothe 25-year-olds in smart, chic, fashionable ideas for a great price," Oldham says.

Although harnessing the power of a celebrity designer was by then common, few retailers had tried it the way Old Navy set out to. Usually designers put together a line of their own or create a one-time collection to get people talking. Either way, they are fairly isolated from the everyday workings of the company. Oldham, however, who traveled back and forth between New York and San Francisco, was supposed to inspire and motivate the designers in any way he saw fit. The idea of a well-known fashion figure hovering over the entire creative process at a retailer the size of Old Navy was an altogether different undertaking, one that would require finesse and tenacity.

Changing Old Navy's attitude toward design was going to be

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a challenge, especially for someone working part-time and without any direct authority or reliable means of persuasion. To spark designers' imaginations, Oldham created a library of fashion monographs, old magazines, and catalogs that reflected his aesthetic: bold, colorful, retro. He showed a marching band uniform, a varsity sweater; he combined a Fifties prom skirt with a ski sweater from the Seventies. "My ideas weren't supposed to go into the stores," Oldham says. "What inspires a designer might horrify a merchant. My goal was to inspire the designers to create something appropriate for the merchants."



Oldham's ideas were criticized as being too retro, too expensive, or too eccentric

BRAD TRENT

But it quickly became clear that some of Old Navy's more literal-minded merchants were skeptical that the designers could interpret Oldham's ideas. "Right from the beginning, I sensed that Todd wasn't the right fit," says David Fox, who returned to Old Navy in November 2007 after a three-year absence specifically to work with Oldham. "As much as the company may want to be creatively driven, it hasn't ever been. It wasn't then. It isn't now. In order to be successful there, you have to understand that."

HOW TO PLAY IT 060

As 2008 began, the recession was taking hold, and Old Navy's sales during the holiday season had been discouraging. By then Gap had a new CEO, Glenn K. Murphy, who had previously run Canada's largest chain of drugstores. Insiders say the more aspirational strategy Murphy had inherited went against his instincts and that he felt the necessary cultural shift would be too hard to pull off. Murphy decided to make some changes.

In February, after 16 months as Old Navy president, Robertson announced her departure. Many were shocked. "[The leadership] bought into Dawn's premise from Day One," says Sheryl Clark, who has since left as the merchandising chief. "I sat in the board meetings. We looked them in the eyes and told them who we were going after. Someone else might have made adjustments. We didn't evolve it, we tossed it. It was a fast death."

Robertson was replaced by Tom Wyatt, genial and soft-spoken, who in his two years at Gap had been president of GapBody and the outlet division. He took the position at Old Navy on an interim basis with orders to rethink who the customer should be. It turned out to be "Jenny," a 25- to 35-year-old recession-weary mom who shops for her family first, then herself. Most people quickly readjusted. In March 2008 sales had plunged a shocking 27% from the previous year. The disaster seemed to justify a change in strategy.

Old Navy's experiment with fast fashion was over, and Oldham found himself without a powerful advocate at a time of great flux. Some key executives began to openly dismiss his ideas as too retro, or too expensive, or too eccentric. One detractor, say several who were there, was Michael Ingram Jones, a self-assured and well-regarded executive who led the women's design team. "Todd never lost his passion, but he became less relevant," says Fox, who also is no longer with the company. "There were two visionaries in conflict." (Ingram Jones declined to comment.)

That spring, as Bear Stearns collapsed, anxiety grew, and Old Navy's sales remained dismal, Oldham began to press Wyatt about the launch of his own line. His contract required Old Navy to come to terms about a licensing agreement by October 2008. That didn't happen, and on Feb. 18, Oldham sued Old Navy for not keeping its promise. The retailer fired Oldham two days later by e-mail. The two sides remain at legal loggerheads, though a settlement is not impossible.

In October, Wyatt, by then officially Old Navy's president, told analysts that identifying Jenny "helped us calm and really focus the team." The question is how long the strategy can sustain the retailer. Old Navy may have returned to where it is most comfortable, but that's exactly where it got into trouble before. When the economy improves, the company may find that all it has to talk about is price. Christine Chen, a retail analyst at Needham, says she generally supports the company's direction. But she adds: "Old Navy could have given the [Oldham] collaboration a little more time. A major overhaul like that takes time for customers to figure out." Old Navy may still come to regret its midcourse correction. |BW|

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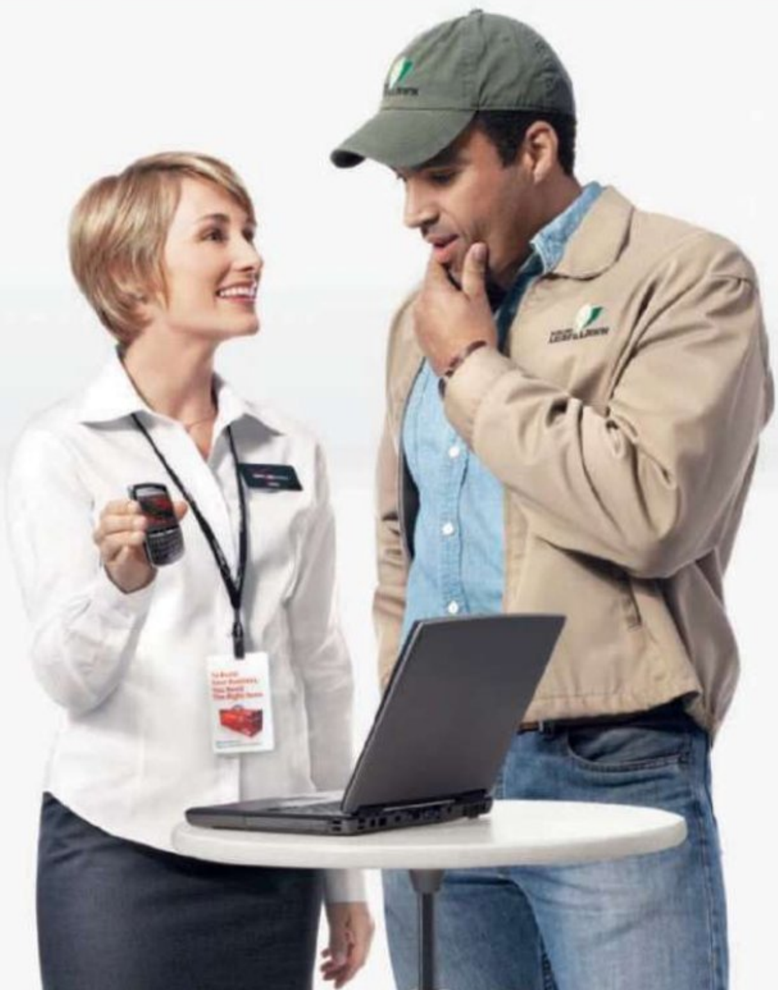
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Dominion's Burgess wants to bring American-style agribusiness to Africa

LAND RUSH IN AFRICA

By Jessica Silver-Greenberg

Photography by Nancy Newberry and Tim Freccia

Agribusiness and global investors are scooping up farmland. Are corporate farmers the new colonialists?

Farmland in developing countries has become an unlikely object of investor fascination. Goldman Sachs, and Morgan Stanley are each raising hundreds of millions of dollars for agriculture funds aimed at Africa and Latin America. Agribusinesses in the U.S. are leasing vast tracts of African land from which they expect to export crops and glean healthy returns. Arab oil countries, meanwhile, are vying for fertile acreage for fear their homelands are running out of water.

The executives leading this hunt for farmland say they are boosting poor economies. Dominion Farms, based in Guthrie, Okla., leases 17,000 acres in Kenya near the village where President Barack Obama's grandmother lives. Dominion President Calvin Burgess boasts that his company provides employment for hundreds of local residents. "This area was a malaria-infested swamp before we got here," he says. Once Dominion is fully in gear, it plans to sell rice to African governments and export farm-raised fish to Europe.

But in Kenya, foreign land investors are beginning to stir resentment. Subsistence farmers and cattle herders complain that they are being displaced without compensation. In the Siaya District of southwest Kenya, families say Dominion hasn't offered as many jobs as it claims in the six years since it arrived. Villagers accuse it of polluting water and sickening farm animals—allegations the company denies.

Tensions are rising. Charles Onyango Apiyo, 39, raises cattle in Siaya. A year ago, he says, 10 of his cows wandered onto Dominion property. The entire herd of 150 was confiscated by company employees and taken to a police station. The cattle were held for almost two weeks, during which time 20 died, Apiyo says. More perished from dehydration on the trek back to his land. In an interview on the side of a

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Locals like Apiyo complain they've lost land and livestock without fair compensation

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"GOD HAS PLANS FOR PEOPLE'S LIVES," BURGESS SAYS OF HIS BUSINESS IN AFRICA, "AND I THOUGHT THAT MAYBE THIS WAS PART OF HIS PLAN FOR ME"

dusty road, he says he has received nothing for his losses.

Dominion's Burgess expresses little sympathy. Stray cattle, he says, can spread disease. "Can you imagine a rice farmer in Mississippi allowing stray cattle onto his field?"

Several factors explain the rush to invest in farmland in Africa. In 2007 high oil prices drove up the cost of crop production and shipping. The resulting spike in food prices was exacerbated by severe droughts in Eastern Europe and Australia. Sensing opportunity, investors and corporate farmers went shopping in Kenya, Sudan, Tanzania, and Ethiopia. Governments in those countries, which annually accept billions of dollars in food aid, leased land to outsiders in exchange for promises of cash, roads, and schools. Local residents, however, often weren't consulted when land they considered theirs was turned over to newcomers. Centuries-old themes of exploitation inevitably surfaced.

AN UNUSUAL CONFERENCE

In the first half of 2009 private equity funds lined up more than $2 billion to invest in farmland, according to Agcapita, a Calgary-based fund. BlackRock has raised $500 million to invest in agriculture. Philippe Heilberg, a former commodities trader for American International Group, has leased 1 million acres in Sudan. Heilberg's New York-based Jarch Capital announced in April that it had acquired the land for an undisclosed amount through a Sudanese firm. Jarch plans to grow rice, wheat, and other crops for export. The owner of the land is Gabriel Matip, a son of General Paulino Matip, the leader of the armed wing of the Sudan People's Liberation Movement, which fought a long war against the government in Khartoum that ended in 2005. In a statement issued to the *Sudan Tribune* in April, Jarch said it planned to lease another million acres by the end of 2009. The completion of that deal hasn't been announced.

In June scores of institutional investors gathered in New York for Global AgInvesting 2009, a first-of-its-kind conference. Among the attendees were employees of the endowment funds of Harvard and New York Universities and the pension plan for San Diego County, Calif. The potential investors were told that in Africa, a little Western technology can fertilize crops and generate profits. "It's a mad scramble for African farmland right now," says Carl Atkin, head of research for Bidwells Agribusiness, a large British company that recruited investors at the conference.

Japan, China, and other Asian countries have operated farms in Africa for more than 20 years. A million Chinese do agricultural work on the continent, according to the U.N. Now a throng of additional outsiders is arriving.

Saudi Arabia held a lavish ceremony in March in Riyadh to celebrate the first harvest from a $100 million rice and wheat project in Ethiopia. In December 2008, Kenyan President Mwai Kibaki flew to Qatar to meet with officials there about a potential deal under which the tiny Middle Eastern emirate would build a port in the coastal city of Lamu in exchange for a long-term lease on almost 100,000 acres to grow rice.

Dominion Farms' Burgess began negotiations in 2002 with the governments of Kenya's Siaya and Bondo districts near giant Lake Victoria. The 58-year-old executive says his interest in Africa was sparked by a member of his church in Guthrie who makes charitable trips to Kenya. Burgess decided to bring American-style agribusiness to Africa. "God has plans for people's lives," he says, "and I thought that maybe this was part of His plan for me."

PLEADING FOR THEIR PEOPLE

Dominion isn't an obvious candidate for farming in Kenya. Part of Dominion Group, a privately held conglomerate involved in real estate development and manufacturing, Dominion once ran prisons for Colorado and other states. Corrections Corp. of America has acquired that business.

When he arrived in Siaya, Burgess rode by Jeep over pockmarked roads to examine land in an area near where the Yala River empties into Lake Victoria. Local officials told him that past irrigation plans had failed, he says. Burgess recounts how he was greeted by two members of the Luo tribe dressed in tattered Western-style suits. The old men pleaded for help for their people, he says. "I made the decision that night."

Soon thereafter, Dominion secured a 25-year lease on 17,000 acres, with an option to renew for an additional 20 years. Burgess says that to obtain the lease he made a series of agreements in confidential documents signed by members of local councils and tribal chiefs. These agreements were approved by the Kenyan Lands Ministry in Nairobi, says Dorothy N. Angote, the ministry's permanent secretary.

Dominion is obligated to pay a total of $140,000 in rent annually. On top of that, Burgess says he paid the Siaya County Council $100,000 two years ago. A county official conceded that the $100,000 vanished, according to local newspaper reports. Separately, Burgess says he paid $120,000 to the local Lake Basin Development Authority in 2003. That money also disappeared, he says. Neither the authority nor the county council responded to several requests for comment.

Dominion also agreed to clear 300 acres of its land for residents to use communally. In addition, it said it would rehabilitate at least one school and one health facility in each of the Siaya and Bondo districts.

More than six years later, these arrangements haven't all gone according to plan. Before the company's arrival, tens of thousands of farming and herding families used parts of the Yala wetlands now occupied by Dominion. Many of these residents have lost access to land they considered theirs. As a legal matter, land rights were held by the various government bodies that leased tracts to Dominion, according to the Lands Ministry. Scores of homes where Dominion now operates were relocated to make way for a dam and reservoir the company built. Burgess says about 50 families were compensated as a result.



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Oware lost five huts to flooding he blames on a Dominion-built dam

TIM FRECCIA

Chris Owalla, a local community organizer, estimates that 300 families were displaced.

Burgess says owners were paid amounts roughly double the worth of their properties. Residents say the compensation—typically 4,600 Kenyan shillings, or about $60 per home—was inadequate. Erasto Odindo, who grows beans, maize, and tomatoes on eight acres in Bondo, says he rejected Dominion's offer because the money was too little.

Dominion has renovated one of the two promised health centers, installing electricity, X-ray machines, and dental equipment. But residents say they have trouble reaching the small facility because the road to it runs through Dominion's farm and company security officers sometimes deny them access. No schools have been renovated, although Dominion has donated building materials for those projects.

By all accounts, the 300 acres Dominion has set aside for communal farming hasn't been used for that purpose. The reasons are in dispute. Burgess blames local officials for keeping people off the land. The officials want to supervise the farming and collect the profits, he alleges. Local farmers, in contrast, say that when they tried to plant crops, they were blocked by the company or saw their maize and rice uprooted by Dominion bulldozers, according to Owalla, the community organizer. Burgess denies these accusations. It is difficult for an outsider to get to the bottom of the matter.

Burgess says that overall, Dominion has improved life for Kenyans. "I disagree when people say, 'Oh, you have to preserve the local culture,'" he says. "If you preserve it, people will starve, and you won't have a culture to preserve." He plays down the idea that land formerly used for subsistence agriculture has now been monopolized by Dominion. Farms that surround his company's property are little more than "unproductive gardens," he says. Most of the area his company now cultivates simply wasn't being used before, he says. "No one was there."

Burgess says Dominion employs 700 local people in various capacities. But villagers dispute this. In 2003 the company hired some 200 people to pull weeds and chase away birds, according to Owalla. As the Dominion farm became more mechanized, jobs dwindled, the activist and local residents say.

During a reporter's visit to the area over three days,

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Workers scare away birds at a Dominion-run rice farm in Siaya, Kenya

some 40 women were observed working at any one time in the Dominion rice paddies. Three men operated tractor equipment along the road. Several of the women said in interviews that they earn less than 200 shillings a day, the equivalent of $3. They declined to give their names for fear of losing their jobs.

FLOOD DAMAGE

Even some local farmers who have kept their land complain about Dominion's presence. Odindo, the farmer in Bondo, reigns as the informal mayor of his neighborhood. While chickens and goats roam the mud-walled front yard of his neatly painted white house, he explains that local farmers fear Dominion eventually will force many of them to seek work in Nairobi—a fate they all dread. "How can you suddenly ask them to change their whole life?"

During severe rains in 2007, Odindo says most of his crops were destroyed by flooding he blames on a nearby dam that Dominion built. He holds up worn photos showing his farm almost totally submerged. "We have never seen that kind of flooding before," he says. More than 1,000 homes were damaged, and some were swept completely away, he adds.

Jackson Oware, who lives nearby, has placed small markers where five of his mud huts stood before the flooding destroyed them. "We are not sure when to replant because it could all be washed away again," Oware says.

Burgess says the ferocity of the storm caused the damage. "We were in no way responsible for this flooding," he adds. "These people just want someone to blame."

Residents report other fears as well. Since Dominion's arrival, they say, drinking water from the Yala River has a metallic taste they attribute to the company's use of fertilizer. Odindo says Dominion's spraying of pesticides has sickened some animals. "Every home has a dead cow or dead goat," he says.

A soil and water analysis in August, paid for by the antipoverty group ActionAid International, concluded that people shouldn't drink from the Yala River. Among the concerns mentioned in the analysis are the presence of dieldrin, a chemical ingredient in some pesticides that has been linked to breast cancer and Parkinson's disease. The Environmental Protection Agency banned dieldrin in the U.S. in 1987.

Burgess says Dominion uses no pesticides in Kenya. Crop-dusting planes that circle the company's property spray only nitrogen-based fertilizers and herbicides—neither of which is harmful, he adds.

Grahame Vetch, Dominion's manager in Kenya from 2004 to 2007, contradicts his former employer on the pesticide question. Vetch, who according to Burgess was fired for poor management, now runs his own land development company in the area. He says Dominion did use pesticides to battle crop-eating pests, such as the quelea bird.

Environmental oversight is weak in Kenya. Selalah Okoth, the district officer in Bondo for Kenya's National Environment Management Authority, says she hasn't assessed water or soil there since she took the job in 2004. Okoth cites a lack of resources, saying she fears there could be harmful pollution caused by Dominion.

Burgess responds with dismay. "When you try to help these people," he says, "all they do is complain." He says his company is trying to foster farming that will attract jobs and investment. He speaks often of his spiritual motivation. A large white Christian cross stands behind Dominion's main facility. Burgess says he erected it after community leaders told him his farm included sites associated with witchcraft.

The American executive has also preached in local churches to promote good relations. But that hasn't gone over well with everyone. "Burgess came into my church and claimed that we didn't know Christ well enough, and we should do it right to prosper," says Odindo. "Well, we are poorer now." |BW|

This article was done in collaboration with the International Reporting Project (internationalreportingproject.org), a nonprofit that provides grants to U.S. journalists.

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Grain Spotting in Africa



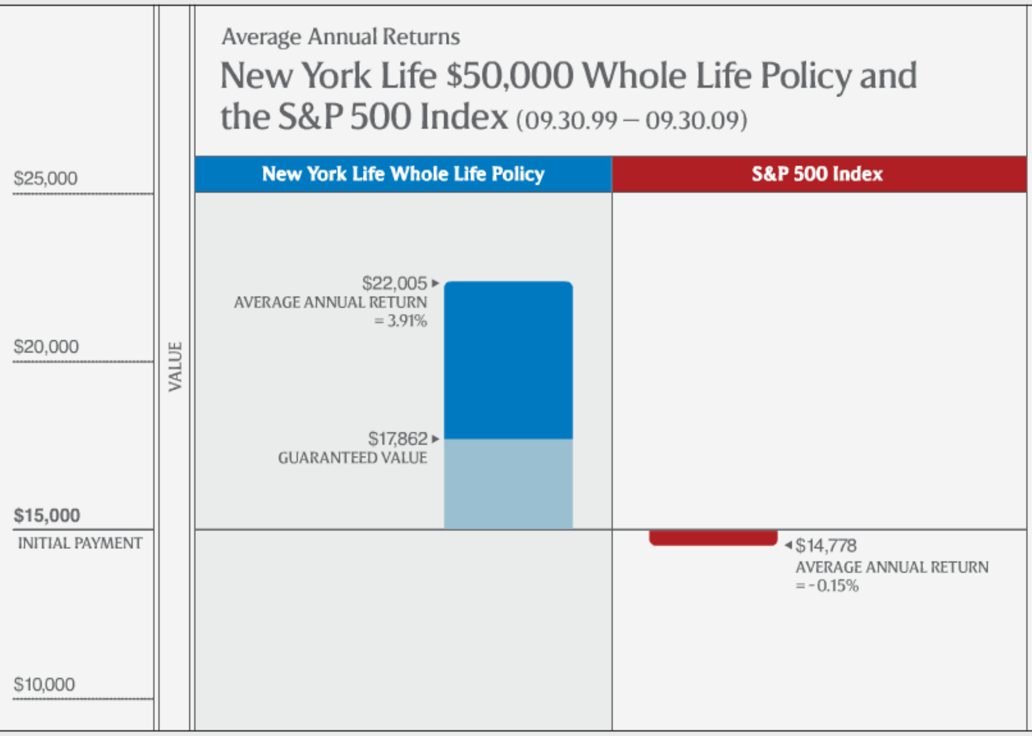
As the race for African farmland picks up, Grain is keeping score. The Rome-based nongovernmental organization aggregates local and international news reports and press releases to assemble a running tally of land deals. The site aims to raise awareness about the vast tracts of land being leased by foreigners in Africa, Latin America, and other parts of the developing world.

To check out Grain, go to **http://bx.businessweek.com/industrial-agriculture/reference/**

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In search of government efficiency: Kundra, Zients, and Chopra

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OBAMA'S BIG GOV SWAT TEAM

By Steve Hamm

Photography by Stephen Voss

How a small cadre of technocrats is trying to make government more efficient

The Obama Administration's huge ramp-up in spending has given rise to a national debate over the size and role of government. It has provoked fears the country will be buried in debt and fueled skepticism about government's ability to spend tax dollars wisely. So the pressure is on: If this is to be an era of bigger government, can Obama's people make it work better?

Jeffrey D. Zients, a little-known ex-consultant, bears a big chunk of the responsibility. He became the nation's first chief performance officer on June 29. His task: making sure the government's 24 major agencies and departments are running smoothly and getting as much bang for their budgets as possible. Working closely with Zients are Vivek Kundra, the chief information officer, and Aneesh P. Chopra, chief technology officer. "At 30,000 feet, the goal is to make government more effective and efficient by making it faster, smarter, and cheaper," says Zients, an intense, crisp-spoken 43-year-old.

Zients, whose name rhymes with science, says he wants to create a "new performance compact." He presses government leaders to set clear priorities and goals and to measure their progress, and he provides management and technology tools to help them deliver. In addition, Zients and his team swoop in to put out fires—such as embarrassing delays in GI Bill payments and the Cash for Clunkers program. The "SWAT team" is how Peter R. Orszag, director of the Office of Management & Budget and Zients' boss, refers to the trio.

Policy experts from the right and left are skeptical Zients can make any substantial progress in his mission. They warn that the federal government—with 1.8 million employees and more than 10,000 computing systems—has become so big and complex that it's nearly unmanageable. Management experts praise Zients for pressing agencies to set goals and show results, but they fear his approach isn't ambitious or grand enough to make much difference, given the task at hand. He's more pragmatic than visionary, they say. "These times require a rethinking of the federal government," says William D. Eggers, head of government policy research at Deloitte Consulting. "Unless we redesign the structure and systems, government will fall farther and farther behind business and society."

Zients disagrees. Although he is aiming to tighten up operations and squeeze more benefits from technology, he doesn't believe a radical reorganization of government is needed. "It's not a time for a brand-new vision. It's a time for execution and results."

Zients and his colleagues have shown they can move fast. This fall, when nearly 280,000 veterans applied for an improved GI Bill education benefit, the demand overwhelmed a stretched Veterans Affairs Dept. staff and an antiquated computer system. The VA sent out emergency checks of $3,000 to tide over veterans, but many were suffering hardships because of the breakdown. The VA asked for help from Zients at a meeting on Oct. 8. At 5:30 the next morning, Zients' team and VA managers caught a flight from Washington to a VA document-processing center in St. Louis. There they paired off with claims processors at computer workstations for three hours and sized up the problem.

On the return flight, a dozen people gathered around Zients and Under Secretary for Benefits Patrick W. Dunne in the aisle of the aircraft and divvied up tasks. VA Chief Information Officer Roger W. Baker recalls that Zients came up with a breakthrough: Since it might take months to hire and train new VA employees, why not outsource simpler tasks to a private firm? The idea has sped up the payments, though there are still some delays. Baker says it demonstrates the quick, commonsense approach Zients, Kundra, and Chopra brought to the crisis.

SHARED BACKGROUNDS

The three have a history together. Chopra worked under then-CEO Zients at the Advisory Board, a research company that promotes operational excellence in the health-care industry. Later, when Chopra was Secretary of Technology for the Commonwealth of Virginia, Kundra worked for him.

There's no mystery about who runs the SWAT team. During a *BusinessWeek* interview in Zients' corner office in the Eisenhower Executive Office Building, he sat at the end of a long table and ran the 90-minute meeting as if it were an audit review, moving quickly from topic to topic and calling on Chopra, Kendra, and adviser Michael D'Amato to fill in details.

A native of D.C.'s suburbs, Zients went into consulting after graduating from Duke University, working at Bain and Mercer Management Consulting. He joined the Advisory Board in 1992 to become head of strategy at age 25. David G. Bradley, the company's founder, made Zients CEO three years later because of his relentless drive. Bradley, now chairman of Atlantic Media, predicts his protégé will be a big asset to the government. "Any discrete problem he's allowed to go deep on, where he's given authority, will be resolved to a high standard," he says.

Zients can come across as intense, but colleagues say he

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knows how to tone it down. He relaxes by going to Washington Nationals games and spending time with his wife and three sons. Agency managers he has worked with say he is more collaborative than controlling. “[He tries] to help with expertise, ideas, and analysis. [He doesn’t] dictate or berate,” says Robert S. Rivkin, general counsel for the Transportation Dept.

A MIDDLE PATH

Still, the precedents for trying to boost government performance are sobering. Clinton’s “Reinventing Government” initiative led to good ideas but little progress. George W. Bush’s top-down approach was aimed at making managers more accountable and outsourcing work to private industry. Some managers felt constrained and outsourcing was no panacea.

Zients is taking a middle path. He has asked agency heads to come up with a handful of high-priority operational goals, with firm deadlines and measurable results—but he leaves it to them to choose the goals. He also encourages letting smart ideas bubble up from the lower ranks.

The goal-setting process won’t end until Feb. 1. But Zients showed *BusinessWeek* a preliminary plan for the Interior Dept. The goal is for the department to green-light enough renewable energy projects on Interior-managed land by 2011 to generate at least 9,000 megawatts—a fivefold increase. Zients says that although most of the goals have deadlines one to two years off, he plans to measure progress on a regular basis.

Zients has set his own cross-agency priorities. They include improving the use of technology, making contracting more efficient, and speeding up hiring. His department just unveiled an initial set of contracting reforms aimed at taking advantage of the government’s purchasing power and saving $40 billion annually from its $500 billion bill for all types of contracts with outside vendors. Each agency is required to come up with a plan that will knock 3.5% off baseline spending on contracting in fiscal 2010 and another 3.5% the following year.

Technology, on which the government spends $76 billion a year, is a key piece of the performance-improvement plan. Until now, each agency ran its tech operations independently. As a result, the number of data centers rose from 438 in 1998 to over 1,000 today. Kundra plans to get agencies to share resources, in part by tapping so-called cloud computing services. In an early test, the government cut the costs of running its main Web site 70% by outsourcing to a cloud provider.

One of Kundra’s moves so far is a computer dashboard that publicly exposes government tech projects, warts and all. The Web site, with graphs and charts reminiscent of a car’s dashboard, shows an overview of federal IT spending and detailed breakdowns by departments and projects. After the site was unveiled on June 30, it was flooded with comments. In response to one, Kundra is requiring the agencies to publish their plans for corrective actions on the dashboard. “We’re changing the government from being secret and opaque to being transparent, open, and participatory,” he says. The dashboard prompted the VA to suspend 45 of its 300 tech projects that were behind schedule or over budget.

Zients and his team use what he calls a “divide and conquer” approach. They gather in his office every Thursday to compare notes about ongoing projects and to launch new ones. Then they split up the tasks. “We get involved early. We uncover root causes that might be different than what people thought was the problem” says Chopra.

But the difficulties with the SWAT projects show how hard it will be to overhaul the government’s operations. Take the Cash for Clunkers program. The Web site auto dealers used to submit applications for rebates crashed repeatedly after the program was launched and took so long to process payments that many gave up in disgust. “The payment side of the program was a disaster,” says Craig Ploetner, president of Towne Auto Group in Union City, N.J. At one point, his Chevrolet dealership was waiting for $70,000 in checks, and he quit the program.

Zients and his colleagues knew they were in for trouble when they were called to help fix the program on Aug. 18. The main problem was excess demand. The computer system had been built for 2,000 applications per day, but more than 20,000 were coming in. So it crashed frequently. Kundra recalls being up until 4 a.m. one night because of a particularly bad crash. They scrambled, increased the number of document handlers from 400 to 4,000 in two weeks, and added dozens of computers. By mid-September all the dealers were being paid. But the reputational damage had already been done.

The GI Bill hasn’t been much better. Christen DeNicholas, a 23-year-old veteran, has been scraping by since starting at Savannah College of Art & Design in September because her payments have been delayed. “I can’t even afford Cocoa Puffs,” she complains. “Does it make sense to have government do more when it can’t take care of what it’s doing now?”

Until Zients and his colleagues come up with an answer to DeNicholas’ question, the critics of Big Government will have the force of public opinion on their side. |BW|

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Washington Report Card

In an era of big government, how can officials execute effectively? Deloitte Consulting’s William D. Eggers and John O’Leary aim to answer that question in *If We Can Put a Man on the Moon … Getting Big Things Done in Government.* The book examines 75 initiatives since World War II and identifies what has worked and what hasn’t.

To view a podcast interview with Eggers, go to **http://bx.businessweek.com/obamas-stimulus-plan/reference/**

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PROFESSION: PILOT CAREER: ACTOR

People are acquainted with the star, the multi-faceted actor. But John Travolta is also a seasoned pilot with more than 5,000 flight hours under his belt, and is certified on eight different aircraft, including the Boeing 747-400 Jumbo Jet. He nurtures a passion for everything that embodies the authentic spirit of aviation. Like Breitling wrist instruments. Founded in 1884, Breitling has shared all the finest hours in aeronautical history. Its chronographs meet the highest standards of precision, sturdiness and functionality, and are all equipped with movements that are chronometer-certified by the COSC (Swiss Official Chronometer Testing Institute). One simply does not become an aviation supplier by chance.

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STRATEGY & COMPETITION

Can Roche Leave Genentech Alone?

Now that it has acquired the biotech superstar, success will depend on keeping some distance

By Arlene Weintraub

Pascal Soirot, a senior executive with Roche, says he was wracked with anxiety while boarding a plane from Basel, Switzerland, to San Francisco last March. The Swiss pharmaceutical giant had just acquired its longtime drug development partner, Genentech, and Soirot was on his way to meet the company's CEO, Arthur D. Levinson, credited with building one of the world's most effective pipeline for cancer drugs. The Genentech products that Roche sold overseas, including Herceptin for breast cancer and Avastin for colon cancer, accounted for 40% of Roche's $42.3 billion in revenue last year. Soirot was awed—and worried. "The first question I asked Art was, 'How do we keep the Genentech spirit alive forever?' " he recalls.



Roche's Soirot worried about fixing what wasn't broken at Genentech

Several of the world's top pharmaceutical companies are spending the final weeks of 2009 digesting some of the biggest acquisitions in their history. Pfizer just closed its $68 billion merger with Wyeth, and Merck sewed up its $41 billion purchase of Schering-Plough. Roche's deal was different: It paid $47 billion to acquire the 44% of Genentech it didn't already own, essentially bringing its most productive unit in-house when the deal closed on Mar. 26.

What all these companies have in common is they must prove to investors and patients that they've learned from past megadeals, which typically generated short-term cost savings but few exciting drugs. "If you look at mergers in the pharmaceutical industry, I don't think we have a long history of successes," concedes Ian T. Clark, a Genentech veteran who will become the unit's CEO starting in January and is serving on the integration team. "Roche knew that the cradle of innovation was the research site at Genentech and that it needed to be handled carefully and distinctly."

Investors expect Roche to get it right: The company's American depositary receipts have climbed 12% this year, to 41.

For nearly 20 years, Roche executives said that Genentech succeeded because it operated at arm's length, maintaining its own shareholders and management team and suffering little meddling from its big stakeholder in Basel. Genentech's sales doubled, to $13 billion, in the five years ended in 2008. And the stock advanced more than 300% in the 10 years leading up to Roche's July 2008 bid for the company. Roche CEO Severin Schwan says the centerpiece of his integration strategy is that he will not impose the Roche culture or way of doing business on the South San Francisco biotech unit. "Most companies think the first thing you have to do after an acquisition is streamline everything," Schwan says. "I have to tell you, this kills innovation."

To keep the ideas flowing from

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Incoming Genentech CEO Clark at South San Francisco headquarters

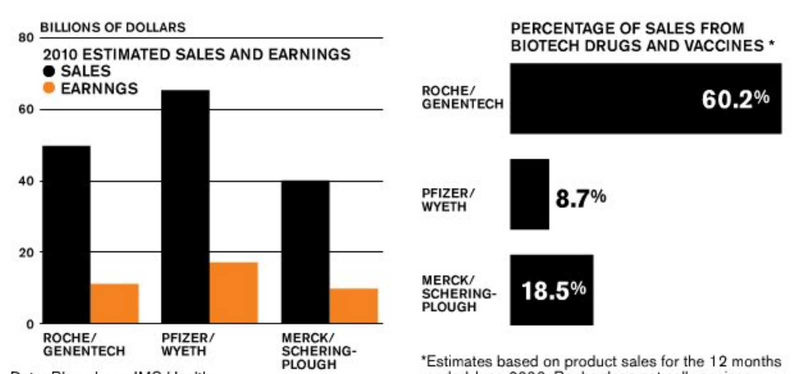
Genentech's labs, Roche left in place almost everything in the research operation, including its senior leadership team. Genentech's scientists will continue to focus on cancer, immunology, and brain diseases. "We have a budget and a completely independent [drug] portfolio that we manage, irrespective of the rest of Roche," says Richard H. Scheller, a nine-year Genentech veteran who continues to serve as head of research. To ensure scientists wouldn't flee from what might now seem like a big, bureaucratic company, Scheller and his colleagues preserved Genentech's university-like culture. The postdoctoral program for fledgling scientists is intact, as are the Wednesday review meetings where researchers present their work to management. And Genentech still throws after-work parties on Fridays, a tradition that stretches back to the company's founding in 1976.

Roche is following a completely different research path from those of its rivals, which have been reshuffling research and development in a desperate attempt to jump-start innovation and make research more efficient. Companies such as Pfizer and GlaxoSmithKline have set up small R&D units defined by what diseases they're pursuing. At Pfizer, the changes have been disruptive: The company said in November it would close six research sites. Roche, on the other hand, is keeping its existing research centers in Basel; Nutley, N.J.; and South San Francisco as independently managed sites. And it's encouraging scientists in all those places to pursue a variety of therapeutic targets—even if their efforts overlap with other Roche sites. Roche scientists from around the world will share results, meeting periodically to decide which molecules have the best chance of becoming drugs. "You need different approaches and cultures and ways of pursuing ideas," Schwan says.

The merger will also allow Roche and Genentech to work together on an elusive goal they share: so-called personalized medicine. Roche leads in this area because it is a pioneer in "diagnostics," or technologies doctors use to determine which patients will respond best to which drugs. Genentech pioneered this approach with Herceptin, a breast cancer drug that comes with a genetic test to pinpoint appropriate patients. When they were separate, Genentech and Roche rarely tried to co-develop diagnostics, because it took too long to work out patent rights and other legal logistics. "Now there's no intellectual-property discussion, there's no negotiation—we're the same!" Scheller

DRUG COMPANY MERGERS BY THE NUMBERS

Roche's Genentech deal helps it compete with newly merged rivals... **...and makes it a leader in biotechnology**



Data: Bloomberg, IMS Health

*Estimates based on product sales for the 12 months ended June 2009. Roche does not sell vaccines.

CHART BY LAUREL DAUNIS/ALLEN/BW

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says. "You wouldn't believe how much easier it is." Genentech has already set up partnerships with Ventana Medical Systems, a U.S. diagnostics company Roche acquired in 2008.

A DIFFERENT COURSE

While Pfizer and Merck have been laying off scientists, Roche has let go fewer than 1,000 employees, almost all of whom worked in service functions. Analysts predict the company will continue spending more than 20% of sales on R&D, outpacing the 15% or so that most large drug companies spend. Schwan predicts the merger will eliminate $800 million in costs next year, nowhere near the $3 billion to $4 billion in savings Merck and Pfizer expect from their deals. But Roche could turn in double-digit earnings growth because it is so heavily concentrated in high-margin products such as biotech drugs (table). "It has a defensible base business that makes it different," says Jeffrey Holford, an analyst for Jefferies Group in London. He expects Roche to chart compounded annual earnings growth of 13% through 2013, helped by tax efficiencies gained from owning Genentech outright.

Schwan is so determined to leverage Genentech's reputation that he rebranded all the drugs Roche sells in the U.S. as Genentech products. Even nonbiotech names such as Valium and Tamiflu now carry the name Genentech. Embracing an acquiree's identity is a rare move in the drug industry, but it sends a powerful message to employees, customers, and investors. "If you're buying an organization because you feel it's an extremely productive innovation engine with a precious culture, you keep the name," says Peter Tollman, a vice-president in Boston Consulting Group's health-care practice.

Genentech's former CEO Levinson isn't ready to call Roche's strategy a success quite yet, but he's encouraged that none of Genentech's top scientists have left. "I was apprehensive because our cultures are not perfectly concordant," says Levinson, who is now chairman of the unit and will join Roche's board next year. In the end, he adds, he found that "Roche has a deep appreciation for protecting the science." |BW|

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STRATEGY & COMPETITION

Siemens Rides The Offshore Winds

It lags in the global wind power race—except in the fast-growing nautical niche

BY JACK EWING



BRANDE, DENMARK

German engineering giant Siemens looks like an also-ran in wind turbines. It's in sixth place globally, with 7% of the market, well behind leaders Vestas and General Electric. Yet the headquarters of Siemens Wind Power has plenty of bustle. Under the overcast skies of Denmark's Jutland peninsula, workers are putting the final touches on a vast parts warehouse. In a slate-gray factory, others are building an assembly line that will churn out 2.3-megawatt turbines the size of buses. Nearby, temporary offices house many of the 1,000-plus new hires since early 2008. "When we started to talk about wind, people looked at us a little strangely," says Siemens Wind Power CEO Andreas Nauen. "Now we're a grown-up member of the Siemens family."

The Siemens unit is thriving thanks to a niche strategy: It focuses on sales of turbines and related gear for use offshore, rather than on land. In that growing market, Siemens is No. 1, with more than half of all sales in 2009. In the past year, Siemens has won huge orders for offshore projects, including a $4 billion deal to provide 500 turbines to Denmark's DONG Energy for the North Sea. "We had been constructing wind parks one by one. Now we are trying to industrialize production," and Siemens was the only supplier able to provide so many machines, says Anders Eldrup, DONG's chief executive.



BOB STRONG/REUTERS

A huge wind farm, built with Siemens' turbines, off the coast of Denmark

Siemens' close ties to utilities—which dominate complex offshore projects—give the German company an edge

Offshore projects let the Munich conglomerate exploit its close ties with utility companies. Long a force in electricity generation and transmission, Siemens has years of experience working with European power companies such as DONG and Germany's e.on, which dominate the offshore market. Onshore projects, by contrast, are less complex and tend to be built by newcomers to the power business, so Siemens doesn't have a built-in advantage. "They understand the issues utilities have," says Eduard Sala de Vedruna, an analyst at Emerging Energy Research in Barcelona.

Those offshore orders helped push Siemens' renewable energy sales up by 55% in the nine months through June, to $3.4 billion, while profit nearly doubled, to $450 million. Siemens' wind business has grown nearly sevenfold since the company entered the market in 2004 via its acquisition of Brande-based turbine maker Bonus Energy, an offshore specialist.

Rivals are starting to follow Siemens' lead. GE has focused almost exclusively on the land-based market in the U.S., but in September it bought Norway's ScanWind. The $18.5 million deal gives GE access to "direct drive" technology, which eliminates many moving parts. That's important offshore because it reduces the chance of a breakdown, saving the cost of dispatching workers by boat to make repairs. "Offshore, reliability is critical," says Vic Abate, a vice-president at GE Energy, which sold $6.7 billion worth of renewables-related equipment and services last year.

Siemens knows it must broaden its focus to reach its goal of becoming the No. 3 producer of wind turbines globally by 2012. While offshore capacity may grow tenfold in the next decade, it's still a scant 1.5 gigawatts globally—a sliver of the 120 GW installed on land, where costs are about half of those offshore. So Siemens is expanding its turbine-making capacity in the U.S., where almost all new wind farms are on land.

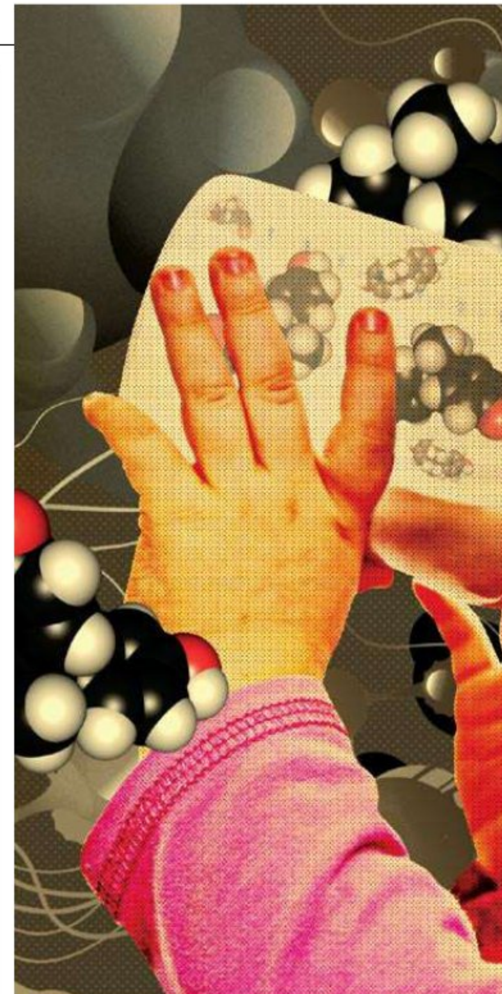
Siemens hopes to guard its dominance at sea with new technologies such as a floating platform for use in deeper waters. The company also is testing its own direct-drive system. But the best sales argument Siemens can offer risk-averse utilities may be its track record offshore. Says Siemens wind boss Nauen: "We have a time and knowledge advantage." |BW|

—With Adam Aston in New York

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Getting to the Bottom Of Plastic Bottle Risks

Retailers are demanding vigilance against worrisome chemicals in containers, food, and other goods



SEAN MCCABE

By John Carey

As founder and CEO of baby goods retailer Giggle, Ali Wing does her best to ensure that the strollers, toys, and other gear she sells are as safe as possible. From the time of Giggle's launch six years ago, she avoided baby bottles containing the controversial chemical bisphenol A (BPA). But other products she sells still contain BPA and scores of other chemicals, and she doesn't know what's really safe. "We can't guarantee everything is healthy," she says. "We haven't found a way to get the answers."

Wing's worry over the safety of chemicals "is the question of the hour for the early 21st century," says David Rosner, professor of history and public health at Columbia University. The U.S. and other countries are awash in synthetic compounds—the molecular innovations of our industrial society—with trace amounts of a number of them routinely found in our bodies. Yet "we don't understand what this low-level exposure means," Rosner says. That makes it difficult for the public, and even for experts, to interpret mounting evidence of harmful effects of BPA and other substances. In early November fears were further stoked by a new study linking BPA exposure to male sexual dysfunction among workers in Chinese factories.

The lack of answers is not just a public-health issue; it's a business one, too, pitting industry against industry. In a trend some call "regulation by retailer," companies from Giggle to Staples are responding to customers' concerns by turning up the heat on chemicals and plastics makers, eliminating BPA from products and asking for information on other substances. "This is what happens when effective policies are not implemented," says Roger McFadden, vice-president and senior scientist at Staples, who is frustrated with a regulatory system that has failed to answer these questions. "I hope this is a wake-up call."

Public worries are also leading states to pass their own laws and regulations in the absence of strong federal oversight, forcing the chemical industry to cope with a patchwork of rules. The current federal regulatory system probably served those manufacturers' short-term interests by requiring them to do very little to assess safety. But that "has come back to bite them," says Richard Denison, senior scientist at the Environmental Defense Fund.

Recent flare-ups and public pressure have forced chemical makers to back away from their historical resistance to tougher rules. "There is a lack of confidence in the regulatory structure," acknowledges Cal Dooley, CEO of the American Chemistry Council, the industry's trade group. The ACC is now pushing to strengthen the 1976 Toxic Substances Control Act (TSCA), under which the Environmental Protection Agency has not completely banned a single substance—not even asbestos.

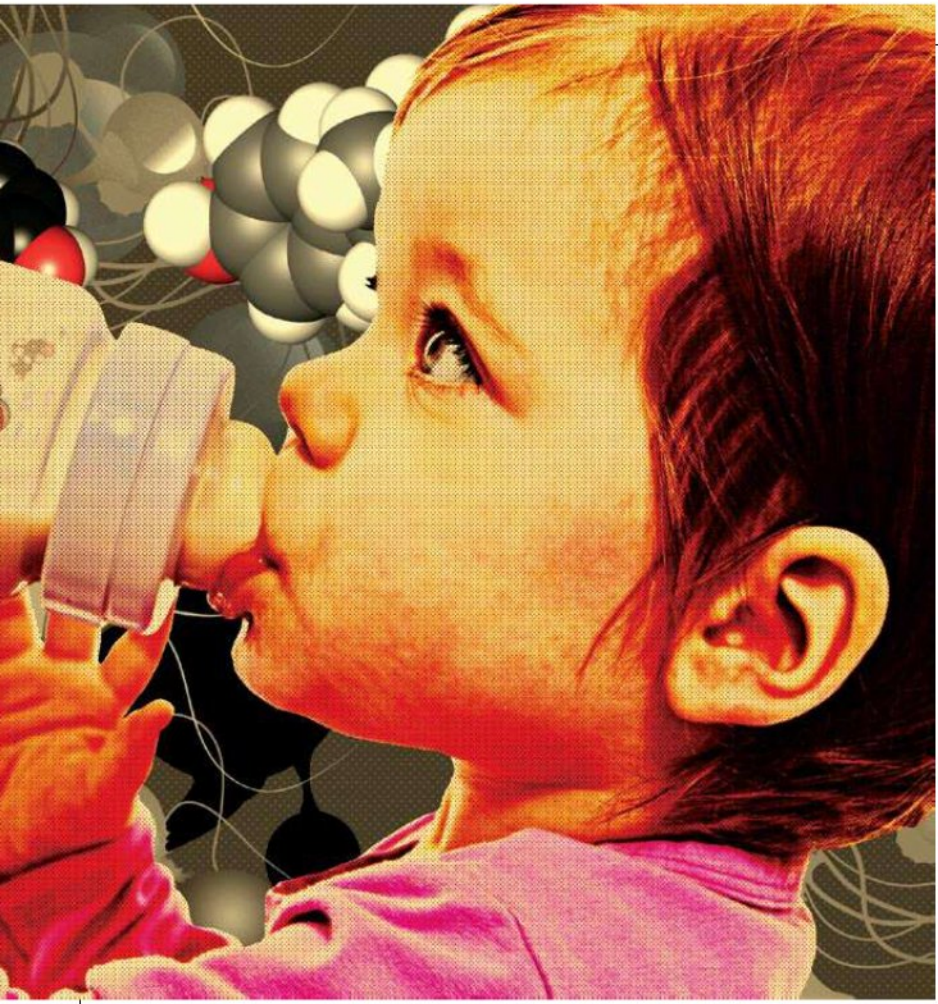
As Congress begins to take up the matter, there's surprising agreement among companies, public-health advocates, and environmentalists on the general outlines of needed reforms. That includes giving the EPA more authority and setting mechanisms to identify and study chemicals deemed most risky. But the details will be thorny, especially because old-style risk-assessment tools aren't good for figuring out dangers from the current low-level exposures.

Unknown Quantities

People are exposed to many substances that may do harm even at low levels:

- **Phthalates** (in food containers, pills, nail polish)
- **PCBs** (banned but still found in the environment)
- **Flame retardants** (in furniture, clothes, electronics)
- **Mercury** (in many fish)
- **Fluoropolymers** like Teflon (in cookware, gears)

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The poster child for these issues is bisphenol A, which is found in a staggering array of products, from food and beer cans to all kinds of plastics. Made at the rate of 6 billion pounds a year, it acts like the female hormone estrogen and also blocks the male hormone androgen. In animal studies, it has been linked to prostate damage, lower sperm counts, and the possibility of cancer. Such results "raise the question of who's minding the store," says toxicologist Gary Ginsburg at the Connecticut Department of Public Health and co-author of *What's Toxic, What's Not*. "We've known since the 1930s it is hormonally active, yet it shows up in everyone's canned food. Why hasn't the light bulb gone off before, just to make sure it's safe?"

One reason is that the science is complex. When someone ingests BPA with his green beans, it doesn't actually get into the body in its worrisome, estrogen-like form. Instead, as part of a natural mechanism for coping with dangerous substances, the body uses an enzyme in the gut to add a sugar molecule to the chemical. That renders BPA inactive as a hormone and speeds its journey to the urine and out of the body. The BPA that researchers detect in urine—it's found in 93% of people tested—is, in fact, in this inactive form.

This quirk of metabolism is crucial to the debate over BPA's safety. Consider the recent study of Chinese workers. Led by Kaiser Permanente epidemiologist Dr. De-Kun Li, the study found that workers exposed to higher levels of BPA reported increases in erectile dysfunction, as might be expected from BPA's hormonal effects. It is the first evidence of problems from exposure in humans, says Li, and the biological disruptions "could just be the tip of the iceberg."

But the workers got BPA through their skin and lungs, where it is not deactivated, points out Steven Hentges, BPA expert at the ACC. In contrast, the stuff that comes from food, where most of us get it, is inactive and safe in the body, he argues.

So is BPA-fear a false alarm? Maybe not. "We think there is a lot more to the story," says Ginsberg. It turns out that the body uses the sugar-adding mechanism not just to disarm toxins but also to shuttle natural hormones around the body in inactive form. When the hormones get to their destination, another enzyme turns them back on. That can happen to BPA, too. One place it gets reactivated is in the placenta, which could result in harmful effects on developing fetuses.

The Food & Drug Administration is now reviewing such studies as it reevaluates the safety of BPA, with an announcement expected on Nov. 30. But the FDA's action won't settle the controversy. The larger problem is that the old-fashioned way of determining chemical safety—giving animals increasing doses until they get sick—just doesn't work for hormone-mimicking substances like BPA. The science that is being done now regarding, say, how humans metabolize BPA does not lead to easy safety determinations. Worries Rosner: "It will take generations to see the impact." |BW|

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Complex Chemistry

The chemical industry has fended off repeated efforts to toughen regulations on BPA and other potentially toxic compounds. In some cases, companies have used aggressive tactics that call to mind Big Tobacco. David Case recounts the tale in a January 2009 investigation in *Fast Company* titled "The Real Story Behind Bisphenol A."

For this and other stories, go to **bx.businessweek.com/chemical-industry/reference/**

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Brigham Young's Entrepreneur Factory

Despite a meager budget for technology research, the Utah university is churning out startups

By Venessa Wong

SMALL BIZ

In an effort to attract dollars, prestige, and top-notch staff, universities have long pushed to commercialize faculty research. That has helped institutions from Massachusetts Institute of Technology to Stanford become hotbeds of entrepreneurialism. The most surprising success, though, may be Brigham Young University.

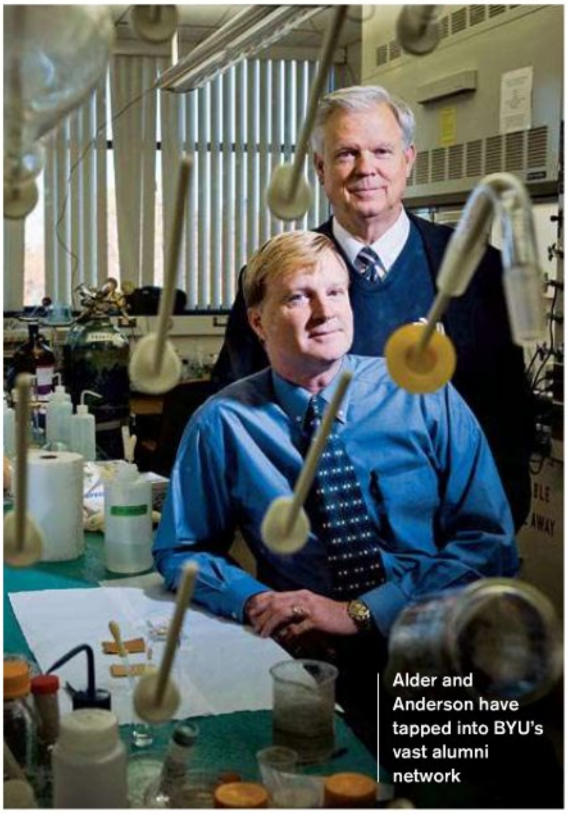
The Provo (Utah) university now ranks first in the country in the number of startups, licenses, and patent applications per research dollar spent, according to the Association of University Technology Managers. BYU-licensed technology led to the creation of nine new companies last year on a research budget of roughly $30 million. Stanford, with a budget of $1.1 billion, spawned the same number of startups.

The private Mormon university set out to beef up its technology transfer department three years ago. It hired Mike Alder, an Alabama venture capitalist, to head the department, as well as Dee Anderson, a lifelong entrepreneur and BYU grad, to be his No. 2. They have tapped BYU's vast alumni network to generate interest in licensing everything from bacteria that consume carcinogens to cutting-edge hearing aid technologies.

When Alder came on board, BYU was issuing around seven licenses a year. The 10-person team (seven of whom are student interns) expects to issue up to 40 licenses this year. "We've stepped up our game, and that's had positive impact," says Anderson.

Alder and Anderson have put much of their energy into building better relationships. They hold weekly meetings with different departments to discuss research in core areas such as chemistry, computer science, and engineering. In September, Anderson set up a LinkedIn group of BYU grads who want to hear about new technologies. That has resulted in several phone calls a week from people interested in using BYU research. The school also started an Entrepreneur in Residence program earlier this year that recruits alumni and business leaders to help evaluate technologies and identify opportunities for startups. It has so far recruited 28 entrepreneurs. While all are unpaid, they can invest in the business ventures they help put together. One entrepreneur is Eliot Jacobsen, a partner at a venture fund called RocketFuel in Salt Lake City. He plans to license an e-mail encryption technology that he discovered through the program. "Mike and Dee are doing [tech transfer] more disruptively," says Jacobsen.

Other universities have set up alumni networks to help commercialize research. The University of Akron in Ohio, which ranked eighth in patents per research dollar, recruits retirees as unpaid senior fellows to help structure licensing deals. At MIT, tapping alumni has long been the norm. As Lita Nelsen, director of MIT's Technology Licensing Office, says: "A lot of the people we work with have [MIT] degrees." What distinguishes BYU, says Diane L. Palmintera, president of Innovation Associates, a consultancy in Reston, Va., is that it's adopting an approach used by institutions with a much greater focus on research.



Alder and Anderson have tapped into BYU's vast alumni network

LANCE W. CLAYTON

BYU has less of a financial cushion than big schools. Alder faces a hiring freeze. And some at the university don't think turning research into business ventures should be a top priority. To a large extent, Alder admits, they're right. "It's not our main mission to be in tech transfer; it's an extra for the faculty." In this environment, though, keeping faculty happy is important. "They can go other places," says Alder. "This is an incentive to stay. |BW|

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FINANCE

The Second Coming Of 'Safer' Securities

Regulators in the U.S. and Europe are backing hybrids, bonds that can morph into stocks. Will investors bite?

By David Henry

Amid the ongoing cleanup of this financial crisis, U.S. and European regulators are trying to figure out how to avoid another one. The latest plan: forcing banks to sell hybrid investments. The securities would morph from a bond into a stock during troubled times, thereby increasing companies' capital stashes and reducing their debt loads. But will the complex investments prevent the sort of panic that depleted banks' capital at the height of the crisis—a situation that prompted the U.S. to prop up the financial system with more than $4 trillion?

At first blush it seems a clever way to pad the industry's cushion of safety. Banks are required by regulators to set aside money to protect against losses. And these hybrid investments ideally would give companies an instant rush of extra capital just when they need it the most, as losses are mounting. That's why the securities, known as contingent convertibles, or "CoCos," appeal to regulators and lawmakers on both sides of the Atlantic. Federal Reserve Chairman Ben Bernanke and Treasury Secretary Timothy Geithner are floating the idea. In early November, Lloyds Banking Group, the largely state-owned U.K. bank, said it would issue up to $12 billion in CoCos.

But these investments have a checkered past. During the boom, banks aggressively sold similar securities, a move that only helped pump up the credit boom. In 2007 financial firms around the globe issued nearly $60 billion in hybrids, triple the amount in 2005. Insurance companies and other big investors gobbled up the investments like debt, figuring they were a safe way to get some extra yield.

Now the same financial instruments are aggravating the bust. Investors who thought they were buying bonds have been left holding something closer to stock. The difference can be painful. The government, for example, suspended regular interest payments on some hybrids issued by Fannie Mae and Freddie Mac after taking over the mortgage giants in September 2008. The U.S. is backing their traditional bonds in full. Prices on other hybrids plunged by as much as 55%. "The market never really dealt with that critical conflict: Is it debt or is it equity?" says Jeffrey A. Rosenberg, credit strategist at Bank of America Merrill Lynch Research.

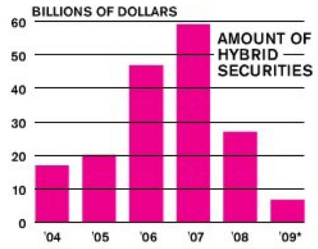
Regulators hope to remove the doubt. In developing the latest version, the triggers for conversion will be outlined in advance so investors hopefully won't be surprised in the end with what they own. In the past the banks had a lot more discretion, and the securities rarely converted into stock, unless a company went belly-up. Now under various proposals, the debt would automatically switch into stock when a bank's financials deteriorate—when, say, troubled loans hit a certain level.

Trouble is, investors may not like this breed. Unlike previous hybrids, these will behave more like equity, which could scare off the usual buyers, who seek safety. Stock investors may not like them since they don't have the same upside potential. As a result, banks may have to jack up the interest rates they pay to attract buyers, a potentially costly proposition.

Meanwhile the securities remain untested. If there are unintended consequences to the risky instruments, they won't be discovered until banks are under pressure and it's too late. "It is ironic," says Simon Adamson of researcher CreditSights. "At a time when you're trying to simplify things, you're getting what appear to be complex securities." BW

A CAPITAL IDEA

Banks sold hybrids to raise money during the boom



Data: Thomson Reuters *Through Nov. 10

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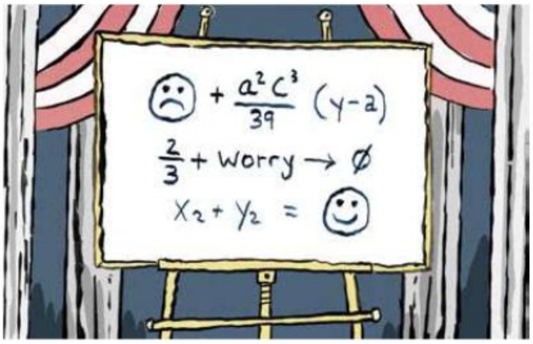
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MAD MEN

A Little Anger Is a Good Thing



Gentlemen: Don't hold in your anger at work. Let it out, says a new study that originally appeared in the *Journal of Epidemiology & Community Health*. A team of Swedish researchers found that men who suppress their anger in the workplace are two to five times more likely to suffer a heart attack or die from heart disease. A big culprit is "covert coping," in which men who feel they have suffered unjust treatment simply walk away or ignore the situation rather than dealing with it. "You have to act," says lead researcher Constanze Leineweber of Stockholm University's Stress Research Institute. "It's better to say that you feel unfairly treated."
–Michelle Fay Cortez of Bloomberg News



ATTITUDE ADJUSTMENT

Wall Street: Paging Dr. Happy



Amid the financial crisis, human resources departments across Wall Street have been grappling with how to handle dark and brooding employees. Three firms, UBS, Credit Suisse, and American Express, hired Shawn Achor—who for the past decade has co-taught one of the most popular classes at Harvard, "Positive Psychology"—to help. The first day Achor walked into UBS's offices in October 2008, employees were ashen faced, he says. They didn't show the slightest interest in anything, even their BlackBerrys. "All these banks were in such dire straits," says Achor, aka Dr. Happy. "Employees had just stopped working."

To get them moving again, Achor held happiness seminars, which explained how contagious upbeat emotions can be in the workplace and stressed the value of psychological vs. financial wealth. Achor also put employees and their managers under a microscope. His findings: Teams whose managers had a positive attitude have less turnover, fewer sick days, and higher productivity.
–M.C.

WORK-LIFE BALANCE

The Rise of the Family Guy

Two MBAs meet on campus. They fall head over heels, marry, and go on to start big-money jobs. Five years later, he flies first class, while she stays at home raising their kids. Such is one of the many marital challenges explored by Stanford Business School professor Myra Strober in her course entitled "Work & Family." The class used to be an exercise in estrogen. But in the past few years it has become wildly popular among men, who now make up 40% of enrollment. "My perfect relationship ... was with a beautiful, smart woman who then wanted to stop everything and put me first," confessed one male student. "It sounds cool, but it's not fair."

Why the sudden rush of male students? Strober attributes the increase to the fact that more young men "want to be the most amazing dads."

In the course, students learn to deal with everything from parental leave to elder care to problems conceiving. "You can't both have killer careers," says Strober. "You need a third parent—or someone has to downsize their aspirations." The class also tackles how much dropping out of the workforce can affect pay over a lifetime. Highly educated women who leave the labor force for two years, for example, earn an average 18% less than if they had continued working.
–M.C.

ILLUSTRATIONS BY MARK TODD

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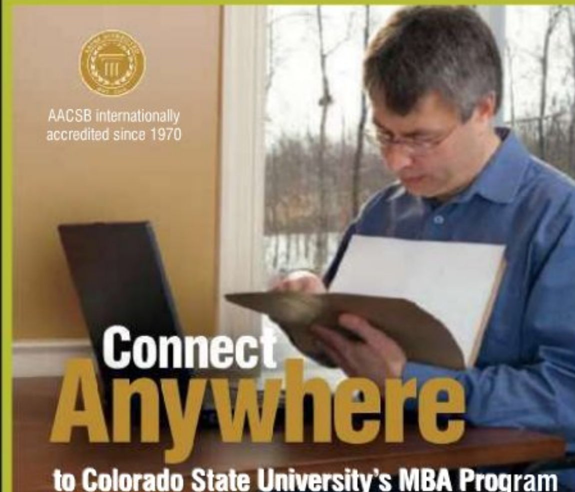
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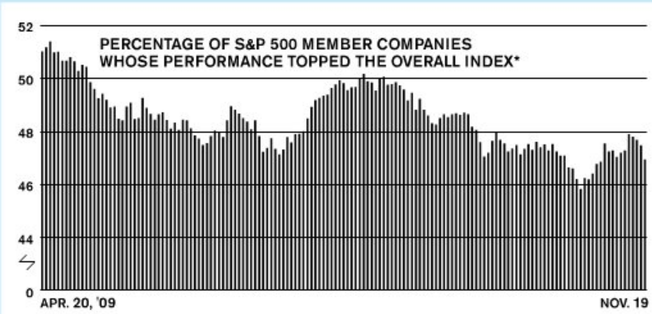
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MONEY REPORT

CAUTIONARY SIGNS?



Data: Bloomberg, *BusinessWeek* *30-day rolling average

As the market hits new highs, technical analysts are seeing danger signs. On Nov. 19 the share of Standard & Poor's 500-stock index companies whose price gains beat the performance of the overall index dropped below 40%. That's a cautionary sign, since it means fewer stocks are taking part in the rally. ¶ Just in November, as of the 19th, the S&P 500 had climbed 6%, advancing its year-to-date rise to more than 24%. Typically, in bull markets, about half the stocks in the index outperform. "There has been a higher probability that a stock purchased 20 days ago would have underperformed, not outperformed," explained analysts at New York research firm Concept Capital in a Nov. 19 newsletter. Over the last 180 trading days, food packager MeadWestvaco is the only S&P 500 company to beat the index more than 60% of the time. Four companies—Exxon Mobil, Southern Co., Quanta Services, and Robert Half International—outperformed less than 40% of the time. *–Tara Kalwarski*

EMERGING MARKETS

TUPPERWHERE?



MICHELLE THOMPSON/AGOODSON.COM

This isn't your mother's Tupperware. The name conjures images of plastic containers and suburban afternoon parties. At the Morgan Stanley Consumer & Retail Conference on Nov. 19, Tupperware Brands' CEO sold the company as something else entirely: an emerging markets play. It has always been an international business, but sales came primarily from developed markets. With the purchase of Sara Lee's cosmetics brands in 2005, the company made a big play for Latin America and Asia. Now roughly half of revenues come from emerging markets, and a weak U.S. dollar makes its container and beauty products cheaper in such places as Brazil. That should drive growth, says Ragen Stienke, manager of WHG SMidCap Fund. Shares, at 46.49, are up 105% this year. Stienke believes "there's a great deal more upside if you take a three-year view." The average analyst 12-month target is 52. *–Ben Levisohn*

VALUATIONS

RICH FARE

Sometimes market appetites push a stock higher than any reasonable measure of its worth. A *BusinessWeek* screen of companies that have inspired feeding frenzies over the past year turned up a range of businesses that, while perhaps deserving of premium valuations, look a bit pricey.

Take Amazon.com. Many investors see good growth prospects, but its stock is up 279% from a year ago. According to data provider Capital IQ, Amazon's price-earnings ratio based on projected earnings for the next 12 months is 57.4. The S&P 500's projected p-e is 14.9.

Shares of health-care information-tech company Cerner also look rich. As policymakers focus on improving the health-care industry's use of technology, Cerner's shares shot up 155% in the past 12 months. But its industry is highly regulated and very competitive. Another highflier: Intuitive Surgical. Shares in the robotic surgery pioneer are up 230% since March. Capital IQ says analysts give the company a target price of about 254, 9% below its current price. *–Ben Steverman*

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(FROM PAGE 030)

By Tara Kalwarski

The retail companies in the Standard & Poor's 500-stock index have outperformed the broad market during the downturn. The S&P Hypermarkets & Super Centers Index, which tracks just two retailers—Wal-Mart and Costco—has risen 9% since the end of 2007. But consumer spending has yet to pick up, and investors are probably better off buying a diverse basket and forgoing bets on individual stocks.



Data: Bloomberg

BROAD BUYS

These three products track retail companies in the U.S. Their various strategies may result in widely different returns.

SPDR S&P Retail ETF (XRT)

74% YEAR-TO-DATE TOTAL RETURN* **63** HOLDINGS

TOP HOLDINGS
Amazon.com (2.3%), Netflix (2.1%), Abercrombie & Fitch (1.9%)

PowerShares Dynamic Retail Portfolio (PMR)

25% YEAR-TO-DATE TOTAL RETURN* **30** HOLDINGS

TOP HOLDINGS
Walgreen (5.8%), Gap (5.5%), TJX (5.4%)

Retail HOLDRs Trust (RTH)

28% YEAR-TO-DATE TOTAL RETURN* **18** HOLDINGS

TOP HOLDINGS
Wal-Mart (21%), Home Depot (11%), Amazon.com (10%)

Data: The companies; Bloomberg *As of Nov. 23

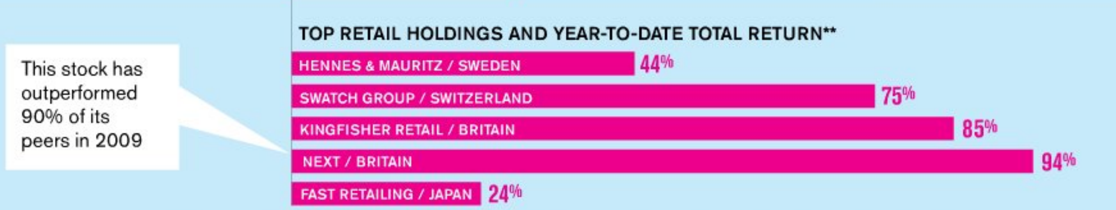
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SHOPPING OVERSEAS

Investing in foreign-based retailers can be difficult, since many aren't listed on U.S. exchanges. But the **SPDR S&P International Consumer Discretionary Sector ETF** allocates 17% to companies such as Swiss watchmaker Swatch Group and Fast Retailing, operator of the Uniqlo chain.

BREAKDOWN OF ETF BY SECTOR





Data: Bloomberg, *BusinessWeek* *Industries with weightings smaller than 3%, including entertainment, food service, telecom, advertising, homebuilding, and textiles **As of Nov. 20

CHARTS BY DAVID FOSTER/BW

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how 144 many 144 years 144 we've 144

been 144 around 144 without 144 asking 144

for 144 government 144 bailout 144 money,

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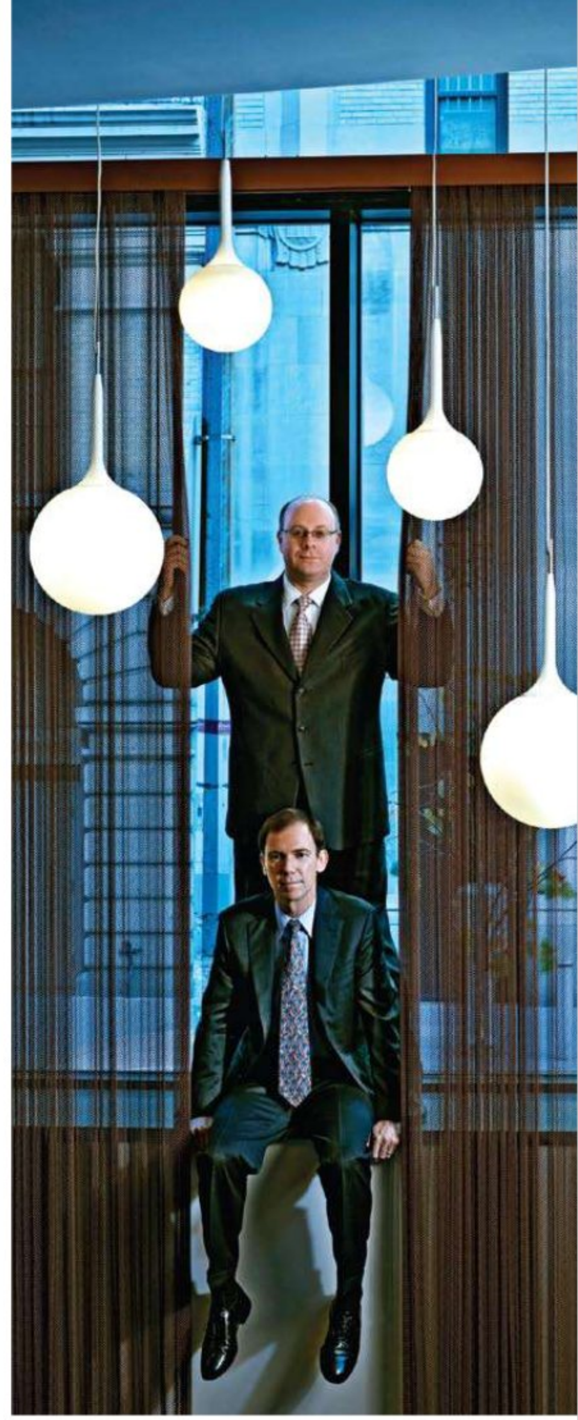
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BEYOND STOCKS & BONDS

'HEDGE FUNDS' FOR EVERYONE

By Amy Feldman



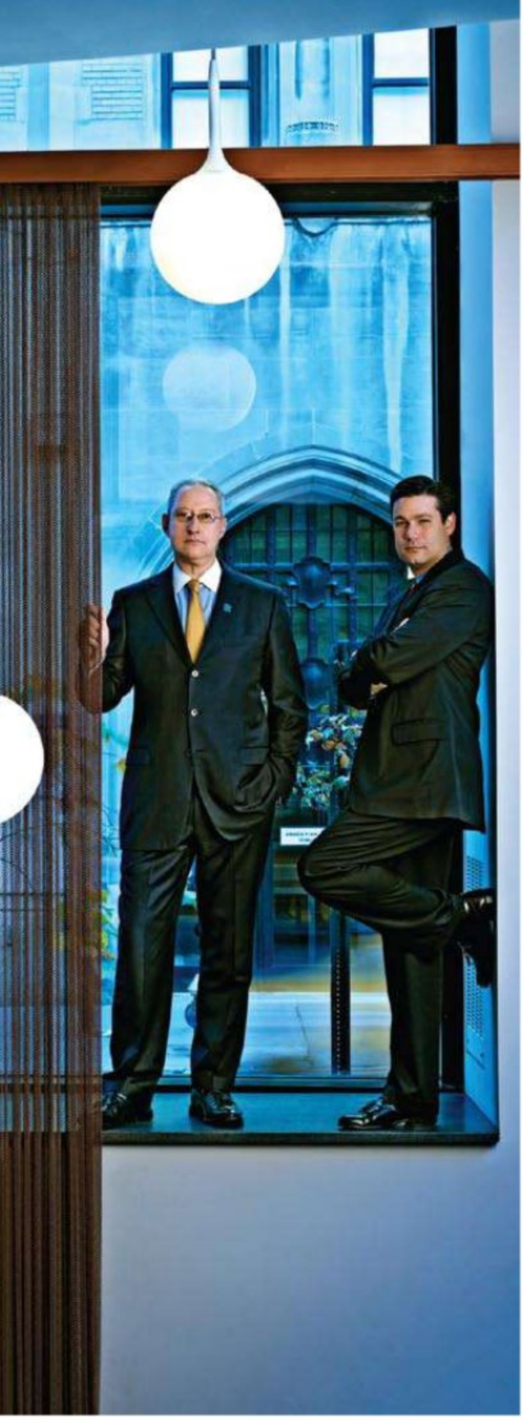
In late October, IndexIQ Chief Executive Adam Patti was crisscrossing the country, from Seattle to Baltimore, giving his spiel about the firm's new alternative investment products to financial advisers in a 20-city road show. The Rye Brook (N.Y.)-based asset-management startup had recently launched two new exchange-traded funds (ETFs), one that tracks inflation and another that invests in a portfolio of global commodities. The firm's flagship product, the IQ Hedge Multi-Strategy Tracker ETF, which aims to replicate various hedge fund strategies, had opened eight months earlier and attracted $74 million in assets.

For years academics and institutional wealth managers have talked about why the typical approach of many individuals to diversification—splitting assets between stocks and bonds—wasn't good enough. But it took the market meltdown for many investors to see just how much volatility, and risk, they were actually taking on by investing in only two asset classes. Now a handful of money managers are launching mutual funds and exchange-traded funds to bring alternative investments to the masses. The appeal: a chance to earn higher returns, dampen volatility, and lower risk. High-net-worth individuals and pension funds are also finding uses for these investment vehicles because of their liquidity and transparency compared with actual hedge funds.

IndexIQ, a startup asset manager that creates its own indexes and then models investment portfolios based on them, is one of those newcomers. Over the past 18 months, it has launched five ETFs and one mutual fund that aim to replicate hedge-fund returns, give investors protection against inflation, and let them participate in merger-arbitrage opportunities. It has received regulatory approval for another dozen ETFs it plans to begin rolling out this winter. While the company's total assets are tiny, at around $200 million, its executives have plans to change the investing landscape in as dramatic a way as Vanguard Group did 30 years ago with index funds. "Our mandate is audacious: We want to be the Vanguard of alternative investments," Patti says. "Why should it be only sophisticated investors who get full diversification?"

Historically, access to alternative investments had been limited to institutional and high-net-worth investors who had hedge funds or separately managed accounts, which are personalized portfolios for wealthy individuals run by financial advisers. But academics had been struggling with the question of how to measure and capture "alternative beta." That is the portion of investment returns from alterna-

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The IndexIQ team (clockwise from left): Whitelaw, Patti, Davidow, and Bruno

BRAD TRENT

tive asset classes, such as those held in hedge funds, that is tied to the asset's underlying market. The return that is a result of a manager's skill is known in financial parlance as "alpha." The evolution of equity index funds such as those tied to the S&P 500 had allowed investors access to the equity market's performance, or beta return, at low cost. But when you move beyond stocks to oil or merger arbitrage or hedge-fund returns overall, the issue becomes: What exactly is the beta return? With no investable index to function as a benchmark, how do you create a portfolio that captures a market's return?

IndexIQ is not alone in asking those questions. AlphaSimplex Group, an asset manager started by Massachusetts Institute of Technology finance professor Andrew Lo and owned by fund conglomerate Natixis Global Asset Management, brought out its first mutual fund, Natixis ASG Global Alternatives Fund, in September 2008. The fund, with $161 million in assets, uses futures and forward contracts to get investors exposure to global equity, interest rate, currency, and commodity markets. In October, ETF giant iShares, which has more than $300 billion in assets, launched its own hedge-fund replication product, iShares Diversified Alternatives Trust. Other players in the field include Goldman Sachs, WisdomTree Investments, and PowerShares.

Some of these new products are actively managed, while others take a passive approach. They run the gamut in terms of strategies they try to replicate at lower cost. The competitive rush to create new products quickly risks pushing some bad products onto the market, or leaving some new alternative funds and ETFs without enough assets to be viable. But investment strategists, analysts, and academics believe that diversifying beyond stocks or bonds and having the flexibility to bet whether an investment will gain or fall in price will help investors get protection against volatility. "We think that the investment landscape has changed permanently," Lo says.

With investors jolted by last year's market meltdown, alternative funds have been gaining assets rapidly. Flows of new money into hedge-like products added $5.4 billion in the first nine months of 2009, atop a $5.7 billion net inflow in 2008, according to Financial Research Corp. Assets now total $39.9 billion. IndexIQ's multistrategy ETF, launched in March, had $40 million in assets by August; by November, assets had almost doubled to $74 million. "In the ETF space, the first mover wins," Patti says. "If you miss being the first mover by one day, you lose."

Adam Patti, 38, is a serial entrepreneur who found himself in the right place at the right time. In his 20s he had been an investment banker, founded a supply-chain software company that failed when the dot-com bubble burst, and started another company that analyzed business processes of small- and midsize manufacturers, which he sold to a group of employees and investors. In 2000 he landed at Time Inc. as associate publisher for its Business and Finance Network. While there, he worked to create investable indexes such as one that tracked the Fortune 500 list of companies. Six years later, with the ETF industry booming, he co-founded IndexIQ with the notion of expanding the index approach to alternative asset classes. "Indexing had not really evolved since the 1970s," says Patti. "We thought we could bring value to investors with alternatives. That was the crazy idea."

Actually, it was a pretty straightforward idea but tough to execute. High-net-worth investors had been adding alternative asset classes to their portfolios with hedge funds, but few regular investors were qualified to invest in hedge funds, and those who did faced high fees

The market meltdown highlighted the risk of investing in only stocks and bonds. A new wave of funds will make it easier to diversify

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and restrictions on when they could take money out. So there seemed a clear need for Patti's "crazy idea." But how to marry the concept of indexing with alternative assets was not clear at all. Hedge-fund data is problematic, and there isn't an existing index of hedge-fund returns that's remotely equivalent to the S&P 500 for stocks. IndexIQ decided it needed to come up with a way to create customized indexes and build portfolios based on them.

TAKING EMOTION OUT OF IT

To do that, Patti and his 16-person team brought on Robert Whitelaw, a finance professor at New York University Stern School of Business, as its chief investment strategist and intellectual heavyweight. Whitelaw and Salvatore Bruno, his research counterpart inside IndexIQ, created six investment strategies for each of the main hedge-fund strategies, such as global macro or equity long/short.

To turn those indexes into its first multistrategy fund and ETF, IndexIQ ran computer models to help decide which of the six strategies should get more money, and which less. The resulting mix gets rejiggered monthly, keeping within strict parameters, such as not moving any strategy by more than 10% within a month, to help control volatility. Fees on the ETF run 75 basis points; the mutual fund's expenses run 1.4%.

One money manager early to see the potential in IndexIQ's approach was David Garff, chief executive of Accuvest Global Advisors of Walnut Creek, Calif. Garff had been struggling to create his own hedge-fund replication product for clients when he heard about IndexIQ. In July, Accuvest began adding IndexIQ's multistrategy ETF to the portfolios of its largely Latin America-based high-net-worth individuals and foundation clients. Garff says his clients have more than $10 million in that ETF and the new inflation-tracking product. "We were early adopters," he says. "We are not done by a long shot with those guys."

Patti and his distribution chief, Anthony Davidow, formerly with Morgan Stanley, expect the inflation-tracker ETF to be a hit. Investors have flocked to Treasury Inflation-Protected Securities, or TIPS, yet the volatility of TIPS makes them problematic for those worried about short-term inflation. TIPS were designed to protect against inflation when held to maturity. IndexIQ's ETF seeks to create a liquid portfolio that can protect against short-term inflation.

How big a deal could these new products become? With worldwide mutual fund assets topping $20 trillion, if even a sliver moved to alternatives the amounts invested would be astronomical. "The ETF industry is growing so fast, and there are no established players on the alternative assets side," says Morningstar analyst Bradley Kay. "There is a lot of excitement about alternatives." | BW |

ALTERNATIVE INVESTMENTS FOR THE MASSES

IndexIQ has six products on the market and a dozen more in the pipeline. It hopes to create a portfolio of low-cost, indexed alternatives that span hedge-fund replication, inflation tracking, merger arbitrage, and distressed investments.

INVESTMENT/TICKER	LAUNCHED	ASSETS	STRATEGY
IQ Alpha Hedge Strategy/IQHOX	June 2008	$38 million	IndexIQ's only mutual fund offering tries to replicate hedge-fund returns and uses leverage. The fund, its oldest, gained 25.9% over the past year.
IQ Hedge Multi-Strategy Index ETF/QAI	March 2009	74 million	IndexIQ's biggest product seeks hedge-fund-like, low-volatility returns with moderate correlation to stocks and bonds.
IQ Hedge Macro Tracker/MCRO	June 2009	7 million	Aims to track the returns of hedge funds that play on macroeconomic trends or that have an emerging markets strategy.
IQ CPI Inflation Hedged ETF/CPI	October 2009	3 million	Seeks to hedge against changes in the U.S. inflation rate by tracking a proprietary index.
IQ ARB Global Resources ETF/GRES	October 2009	6 million	Attempts to offset inflation through exposure to a diversified portfolio of commodity-related equities worldwide.
IQ ARB Merger Arbitrage ETF/MNA	November 2009	3 million	This new merger-arbitrage ETF is designed to give investors exposure to global corporate mergers-and-acquisitions activity.

Data: Morningstar, IndexIQ

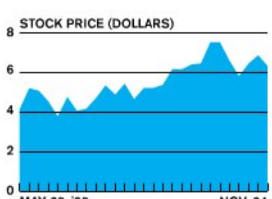
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CLIMBING BACK AT OFFICE DEPOT

Office supply distributors have been battered as job losses and spending cutbacks continue to mount. So the Street has kept away from Office Depot (ODP), one of the world's largest office-products suppliers, whose shares dropped from 39 in 2007 all the way to 1.57 in 2008 before perking up earlier this year.

OFFICE DEPOT: ON THE MEND



Data: Bloomberg

The stock, trading at 6.28 on Nov. 24, "is a turnaround play in the rebounding retail sector, which has caught many analysts off guard," says Bernie Schaeffer, CEO of Schaeffer Investment Research, which acquired shares on their way down. According to Bloomberg, 3 analysts rate it a sell, 12 a hold, and only 2 a buy. Yet the stock has made good progress this year, says Schaeffer. Its steady rise in recent weeks is continuing the uptrend, he says. The third-quarter loss Office Depot posted was less than analysts had feared, indicating a turnaround, he adds.

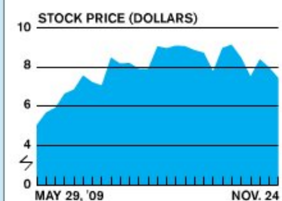
"The macro environment is in the early stages of a slow recovery," says Christopher Horvers of JPMorgan, who rates Office Depot overweight, with a 12-month price target of 8. The company's revenues are correlated with gross domestic product, payroll, and industrial production growth, he adds. "The stock requires only a modest recovery for our rating to work," says Horvers. "Stay tuned."

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BRAD TRENT; CHARTS BY DAVID FOSTER

ACACIA THRIVES ON LAWSUITS



Data: Bloomberg

Acacia Is Having Its Days in Court

Tiny Acacia Technologies (ACTG) has crossed swords with tech giants over patent infringement. In some cases—IBM, ConocoPhillips, and SAP—licensing pacts have resulted.

Acacia, which acquires and licenses patented wireless and Web technologies, moves in part on the fate of its lawsuits. Now at 7.58, it could get a lift on a pending case with Yahoo! On May 15, a U.S. District Court in Tyler, Tex., awarded Acacia $6.6 million in damages for its net-related patent suit against Yahoo. Acacia then appealed to increase the damages. If Yahoo settles, Acacia will get a boost.

"Our fourth-quarter sales estimate of $13.5 million and earnings of 1¢ a share could be low if the Yahoo case goes well," says Jonathan Skeels of investment outfit Davenport, who rates Acacia a buy. Acacia has a slew of lawsuits against other biggies,including Oracle, AT&T, and Google, he notes.

ROOM TO RUN AT ACHILLION



Data: Bloomberg

New Drugs From Achillion

At cash-strapped biotechs, funding is as important as coming up with effective new cures. The $27 million cash stash at Achillion Pharmaceuticals (ACHN) is a needed cushion for its development of treatments for HIV and hepatitis C.

"Achillion has the potential to become a strong anti-infection player in biotech," says Edward Nash of investment firm Merriman Curhan Ford, who rates it a buy. The shares, now at 1.88, should hit 7 to 10 in a year, he says, based on the product pipeline. Achillion's elvucitabine for HIV has finished phase II clinical trials. Achillion hopes to team up with a big drugmaker to develop the drug further, says Nash.

Its hepatitis drug ACH-1625 is set for its first human clinical trials. "This is a positive step to unlocking Achillion's depressed value," says Jason Kolbert of ThinkEquity, who rates it a buy, with a target of 4.50. |BW|

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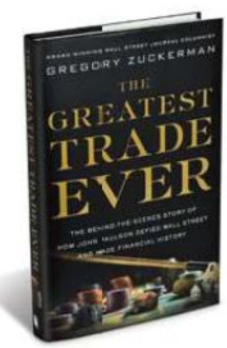
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BOOKS | SPENCER ANTE

Man of the Meltdown

How hedge fund manager John Paulson made billions in the crisis

The Great Recession of 2009 destroyed trillions in wealth. But a few lucky or shrewd souls profited from this catastrophe. Perhaps the single largest beneficiary was John Paulson, a hedge fund manager who engineered the greatest trade in history, earning his firm $20 billion by betting against the housing market. In 2007, Paulson took home a staggering $4 billion for himself, the largest one-year payout in the annals of finance. That's more than $10 million a day, if you're counting.



The Greatest Trade Ever by Gregory Zuckerman; Broadway; 293 pp.; $26

How Paulson and a handful of contrarian investors pulled off this once-in-a-lifetime coup is the subject of *The Greatest Trade Ever* by Gregory Zuckerman, a senior writer at the *The Wall Street Journal*. Paulson has released a statement calling the book a disappointment filled with inaccuracies, which he didn't specify. But *The Greatest Trade Ever* comes off as a fascinating and believable counter-narrative to the growing pile of books recounting the disastrous mistakes made by many of the supposedly smartest minds on Wall Street. It is also a surprisingly dramatic work—although not always in an enjoyable way. It is the drama of waiting to see the horrific destruction scene in an apocalyptic movie.

One of four sons born into a middle-class family in Queens, N.Y., Paulson developed a taste for money at an early age. After graduating first in his class at New York University with a finance degree, he enrolled in Harvard Business School in 1978. One day Paulson attended a lecture by Jerry Kohlberg, founder of the powerful investment firm Kohlberg Kravis Roberts. Kohlberg detailed how his outfit generated $17 million in profit by investing only $500,000 in a company it sold six months later. The possibilities dazzled the young man.

Before Paulson developed the masterful short-the-housing-market strategy that made him a legend in financial circles, he was a mildly successful investor. Paulson's specialty, learned while he was an investment banker at Bear Stearns and Gruss & Co., was merger arbitrage. He set up his own hedge fund, Paulson & Co., in 1994 and produced solid if not spectacular returns betting on shares of companies being acquired. After noticing around 2004 that house prices in Long Island's tony Hamptons were tripling in a matter of years, Paulson began to sense that real estate was getting out of hand, and he



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grew concerned about how this speculation would affect his firm.

That worry was what sparked his strategy. Paolo Pellegrini, a sharp but insecure 47-year-old analyst whom Paulson had hired, suggested Paulson buy credit default swaps as a hedge. Paulson and his team were not familiar with these complex securities, which provide insurance against losses on debt instruments. But the crew eventually mastered this esoteric new world.

A CHEAP WAY TO BET

The beauty of a CDS is that, like an insurance contract, the most you can lose is the premium you pay for protection. If the debt tanks, the insurer must pay you the full amount of the debt. Paulson began by buying CDS contracts that insured the debt of two big lenders, Countrywide Financial and Washington Financial. After his research indicated house prices were overvalued by 40%, Paulson spent $100 million to buy CDS contracts on $10 billion worth of risky subprime mortgages. Like options on a stock, CDS insurance was a dirt-cheap way to place a bet.

Paulson was benefiting from the herd mentality of Wall Street. Investors were so skeptical of Paulson's thesis that he could raise only $147 million from friends and family to start a new credit fund. In 2006, Paulson used that money to buy synthetic CDS contracts that would go up in value whenever the ABX index, which tracks subprime mortgages, went down. That same year Paulson spotted another arcane market being inflated by clueless Wall Street pros: So-called CDOs, or collaterized debt obligations, were a fancy name for securities that gave investors claims not just on mortgages but also on other kinds of debt, such as monthly payments on cars. Investment banks such as Merrill Lynch got addicted to selling CDOs because they earned a 1% to 1.5% fee on the total amount of any deal. In 2006, $560 billion of CDOs were sold. Paulson's firm bought $5 billion in insurance contracts on the riskiest slices of those CDOs.

Initially, Paulson racked up losses on these wagers as housing prices continued to climb. But in February 2007, when subprime lender New Century Financial announced a surprising loss, Paulson pocketed $1.25 billion in one day as the ABX index finally began to drop. Panic soon spread across the financial world, and Paulson's trades began to work their magic.

The subprime implosion brought down many financial institutions. But in *The Greatest Trade Ever*, Zuckerman skillfully shows how Paulson and a few cohorts anticipated a disaster and figured out a way to profit. While Wall Street pros got burned cooking up exotic securities they didn't really understand, Paulson's unconventional strategy—and the courage to stick to it in the face of skepticism—allowed him to make a killing on the crash. **BW**

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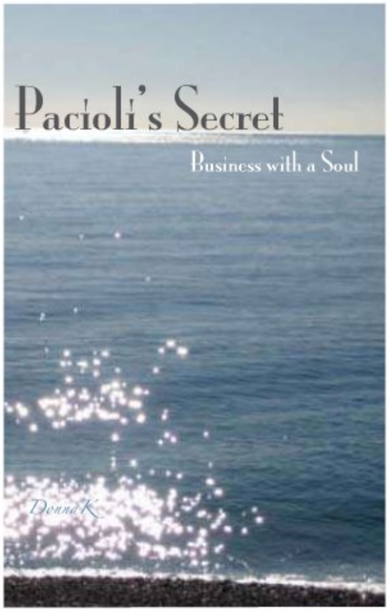
Serendipitous Gamble

In a *Slate* podcast interview with Gregory Zuckerman, the author considers how John Paulson, a merger-and-acquisition man who had no background in housing, happened to be the one trader who foresaw the coming market implosion and was able to capitalize on it hugely. Paulson's firm "backed into this in a lot of ways," Zuckerman explains.

To listen to the podcast, go to **http://bx.businessweek.com/us-financial-crisis/reference**

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9	**STRENGTHS-BASED LEADERSHIP** Tom Rath, Barry Conchie (Gallup Press $24.95) The three keys to being a more effective leader.	11	10
10	**HOW THE MIGHTY FALL** Jim Collins (Jim Collins $23.99) The seeds of destruction can be sewn even as a company rides high.	7	6

PAPERBACK BUSINESS BOOKS

		LAST MONTH	MONTHS ON LIST
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2	**WHAT COLOR IS YOUR PARACHUTE? 2009** Richard Nelson Bolles (Ten Speed Press $18.95) The enduring job-search bible.	10	14
3	**RICH DAD'S CONSPIRACY OF THE RICH** Robert T. Kiyosaki (Business Plus $12.99) Tips plus wiki-style feedback from readers.	2	2
4	**RICH DAD'S INCREASE YOUR FINANCIAL I.Q.** Robert T. Kiyosaki (Business Plus $16.99) Five principles of money intelligence.	1	11
5	**THE SPEED OF TRUST** Stephen M.R. Covey (Free Press $15.95) Nurturing credibility in your personal and professional lives.	11	21
6	**THE RETURN OF DEPRESSION ECONOMICS** Paul Krugman (Norton $16.95) How the failure of regulation allowed the financial implosion.	4	2
7	**SWAY** Ori Brafman and Rom Brafman (Doubleday $21.95) Rational explanations for the irrational decisions most people make.	3	5
8	**THE JOB-HUNTER'S SURVIVAL GUIDE** Richard N. Bolles (Ten Speed Press $9.99) Concise assistance for the jobless.	—	5
9	**BRAIN RULES** John Medina (Pear Press $15) How the brain works and a dozen methods for turning this knowledge into success.	—	3
10	**HOW TO MAKE MONEY IN STOCKS** William J. O'Neil (McGraw-Hill $16.95) A seven-step system for balancing gains against risk.	8	15

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LONG-RUNNING BEST SELLERS

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TECH & YOU | STEPHEN H. WILDSTROM



When Less Is Less

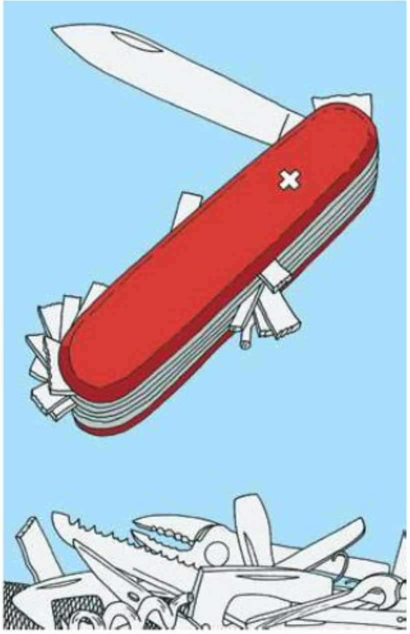
Electronic devices that do only one thing must do them especially well if they hope to survive

The TwitterPeek, a little blue device that looks like a pocket calculator with too many buttons, does nothing but manage your twitter streams. It belongs to an electronic breed that rarely succeeds but never quite disappears: single-purpose devices. From the days of the Apple II on, general-purpose computers have mostly sent more specialized products like these packing. Versatile smartphones, likewise, have demolished the market for Palms and other nonphone PDAs.

Yet some single-purpose devices survive and—in the case of Amazon.com's Kindle and other electronic book readers—even thrive in a multipurpose world.

Reflecting on the TwitterPeek, a seriously flawed device, helped me figure out the secret of specialized success, and it's really quite simple. To have a chance, a specialist must do whatever it does much better than the same function on a more versatile product. Being cheaper won't do it, and neither will simplicity. The key is being better.

Startup company Peek began by offering low-cost wireless devices that provided minimal wireless e-mail for $19.95 a month. I could make a case for an e-mail-only handheld, but a product that does only Twitter is much harder to justify, even if it costs just $200 with lifetime wireless service (or $99 with six months of service, then $7.95 a month). Furthermore, TwitterPeek is far worse at Twitter than Tweetie on the iPhone, ÜberTwitter on BlackBerry, or any other Twitter app I've tried. To me, the real value of Twitter is in the links included in tweets, but TwitterPeek's text-only browser leaves many Web pages unreadable.



BRAD TRENT; ILLUSTRATION BY PETER ARKLE

WikiReader is an even odder single-purpose product. It's a $100 handheld that holds a subset of Wikipedia. It has no Internet connection, so the content loaded onto the device is what you get. There are no illustrations, and links are difficult to navigate. In other words, it's a pale shadow of the real Wikipedia on a PC or even a smartphone.

Some of the single-purpose devices, however, do make sense. My iPhone and BlackBerry take decent enough pictures, but I still own both point-and-shoot and single-lens-reflex cameras. They do nothing but take pictures—video, too, on the point-and-shoot—but they do it vastly better than any phone. I care about pictures, so I carry an extra device.

Specialized gizmos that can make sense include the Kindle e-reader and the Flip, which takes better video than phones

I can read Kindle books on an iPhone and now on a laptop, but I much prefer the Kindle reader. Simply put, the laptop is too big, the iPhone too small. The Kindle is easy on the eyes, comfortable to use anywhere, and if I turn off the wireless function when I don't need it to download books, the battery can last for weeks.

Flip video cameras from Cisco Systems are an interesting tweener case. Even the humblest model takes better pictures than a phone camera and is easier to use. But the gap is narrowing, and it's not clear to me that the elegant Flip is so superior to smartphones that it can survive.

Aside from the iPhone-like Touch, iPods are another example of specialized devices whose era may be ending because they cannot maintain their edge of excellence. Many smartphones now equal the iPod as music players and are better at showing photos and videos. Adding a mediocre video camera to the iPod Nano just isn't enough.

The lesson is that for a specialized device to cut it against more versatile competition, it must hit a high bar for excellence. A decade ago, the PalmPilot crushed the Apple Newton: While it did less, it did it much better. Eventually the Palm, too, was vanquished as smartphones subsumed its functions. Someday e-book readers and cameras may go the way of the PDA and the dedicated word processor. But at least for now, they can depend on the loyalty of delighted users. |BW|

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HEALTH CARE

MORE WAYS TO SAVE

Overwhelmed, perhaps, by the complexities of the health reform bills working their way through Congress, readers seemed to welcome the chance to consider some concrete cost-saving ideas that can be put into action without waiting for legislation ("10 Ways to Cut Health-Care Costs Right Now," Cover Story, No. 23). Many offered their own suggestions. Here, then, we expand the list to include some of these solutions. –*Catherine Arnst*

11. Restructure how we teach our future doctors. Young residents today know technology well. Yet they often don't know how to elicit the stories that can avoid the overuse of technology.

Screen name: Kayt Havens md

12. Promote the use of medical savings accounts, coupled with high-deductible insurance, so that consumers have an incentive to consider cost when deciding what medical services to buy.

James Kirk
FALLBROOK, CALIF.

13. You left out the best place to start: tort reform to reduce the size of verdicts by runaway juries and the contingency fees of John Edwards-type trial lawyers.

Richard Rodgers
ATLANTA



14. Prohibit doctors from having stakes in facilities that conduct medical tests.

Screen name: Doug

15. Overseas health providers could become like Toyota or Honda and set up businesses in America to provide health care more efficiently.

Screen name: Hugo van Randwyck

16. Fund health-care reform by having a national sales tax on edibles and drinkables: Applying a cost to bad decisions and a savings to good decisions will result in better health and lower costs for all of us.

Screen name: Patrick C.

17. Create common goals for hospitals and doctors. Hospital-physician alignment will be the key to reform.

Joane Goodroe, Sr. VP, VHA
IRVING, TEX.

MARKETS

THE ETERNAL CYCLE OF EXCESS

The review of John Cassidy's book *How Markets Fail* ("The High Cost of Blind Faith in the Market," Business Views, Nov. 23) cites Cassidy's belief that "if further calamities are to be avoided," policymakers must embrace reality-based economics. While I agree with this advice, I also think the natural cycle of markets going to excess, regulators responding, and markets going to excess again will never be avoided. The best we can do is to create a regulatory structure that's flexible, focused, and empowered enough to deal with each new excess as it arises.

Nick Balamaci
SCARSDALE, N.Y.

THE ECONOMY

GDP: EVEN LESS THAN MEETS THE EYE

"The GDP Mirage" (In Depth, Nov. 9) says the current GDP estimate is overstated by 1% because it overlooks cuts in R&D, product design, and worker training. Government spending probably contributes 2% to 3% to an overstated GDP. So we can conclude that the economy actually contracted in the third quarter.

Jay McIlroy
LOS ANGELES

RETIREMENT

WATCH OUT FOR HIGHER TAXES ON THAT ROTH

"Should You Roth?" (Personal Business, Nov. 2) failed to explain in its hypothetical example that a worker would have to come up with several hundred thousand dollars up front to pay taxes in the conversion from a 401(k) to a Roth plan. The planner's calculation also assumed that tax rates will be lower for this worker after retirement. My guess is that tax rates will have to rise to pay America's mushrooming federal debt.

Conrad Goldberg, Dean King Graduate School, Monroe College
BRONX, N.Y.

CORRECTIONS & CLARIFICATIONS
A table accompanying "The Most Intriguing New Businesses" (Special Report, Nov. 23) gave an incorrect figure for the amount of money raised so far by Freedom Meditech, a medical device maker. The company has raised $2 million.

PHOTOGRAPH BY TAKA, BASED ON A CONCEPT BY GARY NEIL

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names.
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The Coming Fight for Executive Talent

The inexorable rise of Asia will force the West into a battle for its managers

Whether you can hear it or not, a time bomb is ticking in C-suites worldwide. Its shock waves will resonate for decades. The explosive: indisputable demographics. Surveys conducted by the firm I work for indicate that the number of managers in the right age bracket for leadership roles will drop by 30% in just six years. Factor in even modest growth rates, and the average corporation will be left with half the critical talent it needs by 2015.

There's no defusing this situation. Companies will have little choice but to identify internal talent at an earlier stage and develop prospects at a faster pace. Then comes the heightened competition for talent among companies—and most perilously for the West, among countries and regions.

Next year, Asia's contribution to global gross domestic product will be larger than that of the U.S. and the largest in the world. Its share has tripled in just three decades. On top of this, a wave of privatizations is approaching as governments try to shore up their balance sheets by selling state-owned concerns. The trend is global, but the impact in Asia will be huge, given the number and size of state-owned operations and the room for improvement in their management.

As economic power is redistributed, talent will follow it. I recently learned of a midsize global corporation that decided to move its entire leadership team from Europe to Singapore, ostensibly to "look through the Asian end of the telescope." To attempt such a shift may seem radical, but every single one of the company's eight highest-ranking executives signed on for the move, along with several of their key reports.



Many Asian nations have strong traditions of placing a high value on quality leadership. Some 2,500 years ago Confucius worried about "the dearth of talent." And Asian companies are becoming much more aggressive in their search for top-notch people. But the problem facing Western businesses—and nations—isn't simply that the battle over the best people is moving to the East. Asia is also where the best weapons for winning this war are being developed. The huge demand for skilled people in Asia is making it a hothouse of innovation in acquiring, developing, and retaining talent.

Tata Consultancy Services, for example, calculates a rate of return for each of the tens of thousands of info tech professionals it hires every year out of college. This allows it to arrive at an average rate of return for the schools from which it hires. The company even makes blanket offers to entire graduating classes at the universities that deliver the best employees. And it helps these schools develop courses for the students' final semester so they graduate pretrained for their future jobs.

Infosys Technologies elected to build the largest corporate training center in the world in Mysore, India. It can handle 14,000 employees simultaneously and nicely complements its management training facility, which coaches 400 leadership candidates a year. Accenture India has a sophisticated system for modeling future losses of critical professionals to rivals. The company calculates the value of retaining at-risk employees and acts preemptively—or not.

The developed world continues to offer superior education for knowledge workers and managers. But unappealing policies on executive compensation and immigration are leading to more and more graduating foreign students deciding to return home. On the other side of the planet, nations' arms are open wide, judging by their talent initiatives. China's "Thousand Talents Program" is a concerted effort to attract leading scientists (BW—Nov. 30), and Singapore is working to transform itself into a "career capital"—from a "host" of itinerant global talent to a "home."

The leaders of Western nations have a lot of red tape to cut if they hope to keep their countries competitive, and they'll need good people in government to help them do it. Adopting private-sector hiring and promotion practices would be a good start; so would rethinking compensation policies that set public-sector salaries at a fraction of what the highly competent can expect to earn in the private sector. Companies, meanwhile, should be tying the incentives and the performance reviews of executives to how well they serve their organizations' talent needs.

The global talent war is well under way, even though it's being ignored in many C-suites. But for those willing to face up to it—and fight—the reward can be the ultimate competitive advantage: having the best people in control. | BW |

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